Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Intercarrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68

INTERNET-BOUND TRAFFIC IS NOT COMPENSABLE UNDER SECTIONS 251(B)(5) AND 252(D)(2)

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The Commission has held repeatedly and consistently that traffic delivered to Internet service providers ("ISPs") is interexchange, interstate access traffic that is not subject to reciprocal compensation under 47 U.S.C. § 251(b)(5). That conclusion is correct on legal, technical, and policy grounds. As the Commission has recognized, requiring one local exchange carrier ("LEC") to pay compensation when it delivers an ISP-bound call to another LEC providing service to the ISP creates perverse economic incentives, and (in the Commission's words) encourages "regulatory arbitrage," because of the one-way, high-volume nature of such calls. Specifically, requiring the payment of intercarrier compensation for the delivery of ISP-bound calls artificially insulates Internet users, ISPs, and competitive LECs from the true costs of dial-up access to the Internet, shifting those costs to incumbent LECs and their customers, including those that make no use of the Internet.

The opportunity to collect such compensation, moreover, has encouraged competitive LECs to serve ISPs — often exclusively — simply to reap what the Commission described as "windfall" payments that are out of all proportion to any costs they might incur and that have induced "fraudulent schemes" to generate dial-up minutes. Requiring such compensation also actively discourages CLECs from investing in competing facilities to provide service to residential customers, because each time a residential customer accesses the Internet it imposes compensation liabilities on the originating local exchange carrier. The uneconomic subsidy payments to CLECs, by large, small, and rural ILECs alike, totaled nearly $2 billion annually as of 2000, and have diverted funds that could otherwise have been put to productive use, such as for the deployment of broadband facilities and the innovative services that could be provided over those new facilities.

As the Commission addresses this important issue yet again, we respectfully suggest that it should be guided by the following principles. *First*, the Commission should ensure that its decision will produce economically rational results that promote competition and investment and that benefit all consumers, not recreate the uneconomic subsidy flow that, as the Commission correctly found, had such disastrous consequences. *Second*, as in both the *ISP Declaratory Ruling*[1] and the *ISP Remand Order*,[2] any new rules the Commission might adopt should not retroactively interfere with agreements or with the interpretation of those agreements in light of the legal rules in place at the time those agreements were negotiated. *Third*, the Commission's decision should preserve its authority over both Internet Protocol traffic and intercarrier compensation generally, and should avoid expanding state authority over Internet traffic in particular. *Finally*, more than eight years after enactment of the 1996 Act, the Commission should take all reasonable steps to ensure that its decision will be legally sustainable. To achieve that goal, the decision must comport not only with the first three principles in this paragraph, but also with the terms and structure of the Act, the Commission's precedent regarding Enhanced Service Provider traffic, and the prior judicial rulings on reciprocal compensation under the 1996 Act.

As set forth in greater detail below, several consistent and mutually reinforcing reasons support the Commission's prior determinations that federal law does not require LECs to pay reciprocal compensation for the exchange of ISP-bound traffic. In neither of its two prior orders

[1] Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 14 FCC Rcd 3689 (1999) ("*ISP Declaratory Ruling*"), *vacated*, *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

[2] Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound*

expressly addressing this question, however, did the Commission develop these reasons comprehensively. As a result, both orders were sent back by the court of appeals because they lacked a sufficiently comprehensive analysis of the terms and structure of the Act, and of the background against which Congress enacted it, that the court considered essential. Indeed, the first order was internally contradictory — holding both that federal law did not require compensation for ISP-bound traffic but that state commissions, acting under federal authority, could nonetheless impose such a requirement — and the second was limited to a narrow legal theory that the court did not find convincing. But the court expressly and repeatedly made clear that the Commission can lawfully reach the result that ISP-bound traffic is not subject to reciprocal compensation — indeed, the court clearly signaled that it would affirm that result if the Commission were to provide a thorough and comprehensive supporting rationale, such as that set forth below.

In contrast, interpreting the Act, as some parties have urged, to require payment of reciprocal compensation for ISP-bound traffic at the same, state-approved rates that apply to local voice traffic would be contrary both to the terms of the Act and the Commission's previous construction of those terms, and would not be sustainable. As the Commission painstakingly demonstrated in the *ISP Remand Order*, such a result also is fundamentally incompatible with the pro-competitive goals of the 1996 Act. Because the result these parties have urged is not compelled by the text of the Act, it would be plainly unreasonable — and reversible error — for the Commission to interpret the statute to reach a result that the Commission has already determined promotes regulatory arbitrage in conflict with the Act's fundamental objectives.

Traffic, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*"), *remanded*, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1927 (2003).

BACKGROUND

A. Intercarrier Compensation Prior to the 1996 Act

Following the breakup of the Bell System into separate long-distance and local telephone companies, the Commission and state commissions established access charges, which long-distance carriers (including AT&T) would be required to pay to local telephone companies for the use of their local network facilities to complete interexchange calls. Long-distance carriers paid access charges to both originating and terminating carriers.

Under the Commission's initial access-charge regulations, Enhanced Service Providers ("ESPs") were to pay the same access charges that applied to interexchange carriers ("IXCs") such as AT&T.[3] As the Commission explained in 1983, ESPs are "[a]mong a variety of users of access service," and an ESP "obtains local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location."[4] The Commission subsequently decided for policy reasons, however, to permit ESPs (a category that includes ISPs) to purchase their access service at the rates set forth in LECs' state tariffs for local business lines and to exempt ESPs from payment of per-minute interstate access charges. It thereby effectively set a per-minute access charge of $0 while adopting the rate in state tariffs as the new *federal* rate ESPs would pay. The Commission's rationale for creating this exemption rested entirely on the possibility of a rate shock to an industry subject to considerable regulatory

[3] *See* Third Report and Order, *MTS and WATS Market Structure (Phase I)*, 93 F.C.C.2d 241, 344 (1983); *see also* Memorandum Opinion and Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 682, ¶ 76 (1983) ("*MTS and WATS Market Structure*"); Notice of Proposed Rulemaking, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 2 FCC Rcd 4305, ¶ 2 (1987). In imposing access charges on both IXCs and ESPs, the Commission was following the terms of the Modification of Final Judgment ("MFJ"), in which Judge Greene held that BOCs "will carry traffic between the information service providers and their subscribers" and "will earn access charges for providing this service." *United States v. AT&T*, 552 F. Supp. 131, 190 (D.D.C. 1982).

uncertainty.[5] Although the Commission later suggested, in a 1997 decision retaining the ESP exemption, that "it is not clear that ISPs use the public switched [access] network in a manner analogous to IXCs," it did *not* accept the argument that ESPs are end users, that they should never have been subject to access charges in the first place, and therefore that no ESP exemption was required.[6] Nor did the Commission consider in that order the compensation that one LEC would pay to another when they jointly provide originating service to an ISP; the Commission addressed only whether ISPs must pay per-minute interstate access charges to LECs.

Prior to the enactment of the 1996 Act, there were situations in which two carriers cooperated either to originate or to terminate an interexchange call — that is, where the call merely traversed the second carrier's network. First, smaller, independent telephone companies frequently were not connected directly to IXCs, but instead made use of the connection established by one of the larger local telephone carriers. In that arrangement, when an end-user customer of the independent company made a long-distance call, the independent company would perform a portion of the work in originating the call, as would the larger LEC. The same joint effort would occur when the independent company's customer received a long-distance call. Second, competitive access providers were competing with LECs in the provision of access service, installing transport linking LEC switches and IXC switches. In this arrangement, as

[4] *MTS and WATS Market Structure* ¶ 78.

[5] *See id.* ¶ 83; *see also* Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking, *Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 4524, ¶ 54 (1991) ("*Access Charge Subelements Order*").

[6] First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd 15982, ¶¶ 344-348 (1997), *petitions for review denied*, 153 F.3d 523 (8th Cir. 1998); *see id.* App. B, ¶ 193; *see also Access Charge Subelements Order* ¶ 56.

well, the work of originating or terminating a long-distance call would be performed by two carriers — the LEC that provided the connection to the end-user customer making or receiving the call, and the CAP that provided the connection from the LEC to the IXC. In each instance where multiple carriers were involved in originating or terminating calls subject to access charges, the Commission established rules requiring the two LECs to share the access charges.[7]

In addition, shortly before the 1996 Act, some states began opening local markets in their particular jurisdictions. With the advent of local competition, two LECs could exchange local calls between their customers or could handle interexchange calls — whether jointly originating or terminating the calls (such as where only the ILEC directly interconnected with an IXC) or with one originating and the other terminating the calls (with a third carrier or one of the LECs acting as an IXC and providing the interexchange transport). State commissions adopted new compensation regimes for the exchange of local traffic, but maintained the existing access-charge regimes for situations in which the two LECs handled interexchange calls. Thus, the Illinois commission adopted "one compensation structure for the termination of 'local' traffic and the existing switched access charges for the termination of all other traffic."[8] Similarly, while the California commission established "bill and keep for *local* calls," it also held with respect to *interexchange* traffic that "CL[E]Cs will pay terminating access charges based on the LEC's existing switched access tariffs."[9] These state commissions referred to the new

[7] *See, e.g.*, Memorandum Opinion and Order, *Access Billing Requirements for Joint Service Provision*, 4 FCC Rcd 7183, ¶¶ 21-26 (1989) ("*Access Charge Order*"); Memorandum Opinion and Order and Request for Supplemental Comments, *Amendment of Part 69 of the Commission's Rules To Ensure Application of Access Charges to All Interstate Toll Traffic*, 102 F.C.C.2d 1243 (1985).

[8] *Illinois Bell Tel. Co.*, No. 94-0096, 1995 Ill. PUC LEXIS 230, at *208 (Apr. 7, 1995).

[9] *Order Instituting Rulemaking*, No. 95-12-056, 1995 Cal. PUC LEXIS 966, at * 48 (Dec. 20, 1995); *see also, e.g.*, *Petition of MCI Telecommunications Corp.*, 1995 Ind. PUC LEXIS 399, at *34 (Nov. 21, 1995) (establishing "the form and amount of compensation to be paid for

intercarrier compensation regime to apply to the exchange of local traffic as "reciprocal compensation."[10]

B. Reciprocal Compensation Under the 1996 Act

Congress enacted the 1996 Act against this background of existing federal and state access-charge regimes applicable to interexchange traffic, and the then-recently adopted state compensation regimes applicable to the exchange of local traffic. Like the state commissions, Congress established a new compensation regime for local traffic, but left the existing access-charge regimes intact. Indeed, the legislative history is clear that "nothing in th[e] section [of the Senate bill that became 47 U.S.C. § 251] is intended to affect the Commission's access charge rules." H.R. Conf. Rep. No. 104-458, at 117 (1996); *see* S. Rep. No. 104-23, at 22 (1995) (same). And the Commission itself has recognized that, in the 1996 Act, "Congress was concerned about the effects of potential disruption to the interstate access charge systems" and had similar "concerns about the effects on analogous intrastate mechanisms." *Local Competition Order*[11] ¶ 732; *see also ISP Remand Order* ¶ 37 ("Congress did not intend to disrupt the[] pre-

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completion of local calls between MCI's and Ameritech Indiana's respective networks"); *Application of City Signal, Inc.*, No. U-10647, 1995 Mich. PSC LEXIS 32, at *43 (Feb. 23, 1995) (establishing compensation rules "for local calls"); *Washington Utils. & Transp. Comm'n v. U S West Communications, Inc.*, No. UT-941464, 1995 Wash. UTC LEXIS 47, at *37 (Oct. 31, 1995) (establishing "inter-company compensation for the termination of local calls"); *Application for Electric Lightwave*, No. 96-021, 1996 Ore. PUC LEXIS 7, 11-12 (Jan. 12, 1996) ("compensation arrangements for the exchange of local and Extended Area Service (EAS) traffic"); *Application of MFS Intelenet of Pennsylvania*, No. A-310203F0002, 1995 Pa. PUC LEXIS 89, at *4 (Dec. 13, 1995) (expressing "desire that the parties would agree to an interim compensation rate for the termination of local calls").

[10] *E.g., Illinois Bell Tel. Co.*, No. 94-0096, 1995 Ill. PUC LEXIS 230, at *205-09; *Petition of MCI Telecommunications Corp.*, 1995 Ind. PUC LEXIS 399, at *38; *Application of MFS Intelenet of Pennsylvania*, No. A-310203F0002, 1995 Pa. PUC LEXIS 89, at *2-5.

[11] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*") (subsequent history omitted).

existing" "access regimes"). Congress gave effect to its stated intent both through the express terms used in the provisions that created a new compensation mechanism for the exchange of local traffic, and through other provisions that confirm that this new mechanism was not intended to disrupt the existing exchange access regime.

First, as the state commissions had already done, Congress adopted a new "reciprocal compensation" mechanism for local traffic exchanged by competing local exchange carriers. Unlike other provisions that apply to all telecommunications carriers (*e.g.*, § 251(a)), Congress included the provision creating this new mechanism in a section of the Act that by its terms applies only to interconnecting "local exchange carrier[s]." 47 U.S.C. § 251(b); *see Local Competition Order* ¶ 1001 ("Section 251(b) imposes duties *only* on LECs") (emphasis added); *see* H.R. Conf. Rep. No. 104-458, at 121 (§ 251(b)(5) applies to "all local exchange carriers, including the 'new entrants' into the local exchange market"). Congress also chose terms that both defined the nature of the traffic subject to this new mechanism and imposed specific requirements for any compensation arrangements for that traffic. In the first instance, Congress made clear that the new compensation mechanism applied only to traffic that originates on the network of one LEC and terminates on the network of the interconnecting LEC. Thus, in § 251(b)(5), Congress imposed obligations on interconnecting LECs to establish "compensation arrangements for the transport and termination of telecommunications [traffic]." 47 U.S.C. § 251(b)(5). These "compensation arrangements" were to be "reciprocal" — that is, each LEC was obligated to enter into such arrangements with other LECs, which unlike IXCs would both "transport *and terminat[e]*" the traffic received from the originating LEC. *Id.* (emphasis added).

In the accompanying pricing provision, Congress provided that the reciprocal-compensation obligation extends only to calls that "originate" on one LEC's network and "terminat[e]" on the interconnecting LEC's local network. *Id.* § 252(d)(2)(A)(i) ("recovery by each carrier of costs associated with the transport and termination on [its] network facilities of calls that originate on the network facilities of the other carrier"); *id.* § 252(d)(2)(A)(ii) ("such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of *terminating* such calls") (emphasis added). These terms necessarily exclude interexchange calls, which are the subject of the access-charge regime, because those calls traverse the interconnecting carrier's local exchange network before traversing an interexchange carrier's network en route to delivery and termination to an end user in a distant calling area, perhaps on another LEC's network.[12] In addition, Congress provided that any reciprocal-compensation arrangements adopted under these provisions were to provide for the "mutual" and "reciprocal" recovery of each carrier's costs. *Id.* §§ 251(b)(5), 252(d)(2)(A)(i). It also made clear that any arrangements that did not provide, in some manner, for "mutual" cost recovery would be unjust and unreasonable. *Id.* § 252(d)(2)(A). And it authorized the use of so-called "bill-and-keep" arrangements *provided* that such arrangements nevertheless "afford mutual recovery of costs" — for example, through offsetting of obligations or where each carrier is able to recover its costs from its own customers. *Id.* § 252(d)(2)(B)(i). Each of these provisions, along with the inclusion of reciprocal compensation on the § 271 competitive checklist for *local* competition, *see id.* § 271(c)(2)(B)(xiii), demonstrates that in § 251(b)(5) Congress was creating a new compensation regime applicable only to local calls, just as state commissions, prior to the 1996 Act, had adopted "reciprocal compensation" obligations for local calls.

[12] As noted above, for an interexchange call, the same carrier can act as *both* an IXC *and* a LEC — accepting the call from the originating carrier, and performing the termination to its own end-user customer, who is located in a different local calling area from the end user making the call.

Second, while this alone makes abundantly clear that the new compensation mechanism was not intended to disrupt the existing exchange access regime, Congress further confirmed its intention in other provisions. In particular, § 251 contains *two* savings clauses, each of which makes clear that, in enacting provisions to create local competition, Congress did not modify the FCC's authority over interstate access charges. The more general of the two, § 251(i), provides that "[n]othing in this section shall be construed to limit *or otherwise affect* the Commission's authority under section 201," which includes its authority to establish interstate access charges. 47 U.S.C. § 251(i) (emphasis added). Congress also enacted § 251(g), which requires LECs to continue providing "exchange access[and] information access . . . to interexchange carriers and information service providers" pursuant to existing "interconnection restrictions and obligations (including receipt of compensation)." *Id.* § 251(g). That section also expressly preserves the Commission's authority to "supersede[] by regulation[]" those existing obligations, which include the rules governing a LEC's "receipt of compensation" for services provided to an IXC's or an ISP. *Id.* § 251(g).

In addition, while Congress required telecommunications carriers *generally* to interconnect their networks, *see id.* § 251(a)(1), neither that section nor the provisions imposing additional interconnection obligations on incumbent LECs, *see id.* § 251(c)(2), govern the compensation owed for the transport and termination of traffic exchanged between networks. Rather, as the Commission previously concluded, these interconnection provisions address only the physical connection of networks, and not the compensation arrangements for traffic exchanged between interconnected networks. *See, e.g.*, Memorandum Opinion and Order, *Total Telecommunications Servs., Inc. v. AT&T Corp.*, 16 FCC Rcd 5726, ¶¶ 22-26 (2001); *Local Competition Order* ¶ 176. Accordingly, these various sections provide still further confirmation that Congress did not intend to disrupt either the existing exchange access regime or the Commission's pre-existing authority to modify that regime.

C. The Commission's Interpretation of § 251(b)(5) and ISP-Bound Traffic

Local Competition Order. In its April 1996 Notice of Proposed Rulemaking, the Commission recognized that interpreting the interconnection provisions in § 251 to permit IXCs "to circumvent Part 69 access charges" may be "contrary to Congress' focus in th[at] section[] on promoting *local* competition" and also "inconsistent with other provisions in section 251, such as sections 251(i) and 251(g)," which, as noted above, preserved the FCC's authority over interstate access charges. *Local Competition NPRM*[13] ¶ 164 (emphasis added). The Commission likewise noted that interpreting § 251 to displace the existing interstate access-charge regime "may effect a fundamental jurisdictional shift by placing interstate access charges under the administration of state commissions." *Id.* In seeking comment specifically on § 251(b)(5), the Commission stated that this section "appears at least to encompass telecommunications traffic that originates on the network of one LEC and terminates on the network of a competing LEC in the same local service area." *Id.* ¶ 230.

Virtually all commenters to address the issue agreed with the Commission's tentative conclusion that "Congress intended to confine [§ 251(b)(5)] to local traffic." *Local Competition Order* ¶ 1032. One commenter, Frontier, took issue with that interpretation, claiming instead that § 251(b)(5) "provid[es] for mutual compensation between a local exchange carrier and *any other entity*."[14] The Commission expressly rejected Frontier's claim, holding instead that the

[13] Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 14171 (1996) ("*Local Competition NPRM*").

[14] Frontier Reply Comments, CC Docket No. 96-98, at 19 (FCC filed May 30, 1996) (emphasis added).

"Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic." *Local Competition Order* ¶ 1033. The Commission accordingly held that "section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area." *Local Competition Order* ¶ 1034; *see id.* ("reciprocal compensation . . . is intended for a situation in which two carriers collaborate to complete a local call" and "do[es] not apply to the transport or termination of interstate or intrastate interexchange traffic"); *id.* ¶ 1037 ("section 251(b)(5) obligations apply to all LECs in the same state-defined local exchange service areas").[15] The Commission found that this "reading of the statute is confirmed by section 252(d)(2)(A)(i)," which "provides for recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." *Id.* ¶ 1034 (internal quotation marks omitted).

In addition to rejecting Frontier's efforts to use § 251(b)(5) to avoid the payment of access charges, the Commission rejected attempts by IXCs to use the interconnection obligation in § 251(c)(2) to achieve the same result. *See id.* ¶ 175, 189. The Commission held that "interconnection" in § 251(c)(2) "refers only to the physical linking of two networks" and, therefore, that "access charges are not affected by our rules implementing section 251(c)(2)." *Id.* ¶ 176. The Commission also held that an IXC could not obtain interconnection at TELRIC rates "solely for the purpose of originating or terminating its [own] interexchange traffic," even if that traffic was "originated by a local exchange customer [of the IXC] in a different telephone

[15] These determinations were reflected in the rules the Commission adopted. *See, e.g.*, 47 C.F.R. §§ 51.701, 51.703 (1996) (requiring LECs to "establish reciprocal compensation arrangements for transport and termination of *local telecommunications traffic*," defined as traffic "that originates and *terminates within a local service area*," and with termination defined as "delivery of [local] traffic to the called party's premises") (emphases added).

exchange." *Id.* ¶ 191. Instead, such an IXC would be required to pay the same access-charge rates that applied prior to enactment of the 1996 Act. *See id.* ¶ 191 n.398.

Although numerous parties sought review of the *Local Competition Order*, no party took issue with the Commission's interpretation of § 251(b)(5) as limited to local traffic. CompTel, however, sought review of the Commission's interpretation of § 251(c)(2) and its conclusion that "access charges are not affected by our rules implementing section 251(c)(2)." *Id.* ¶ 176. The Eighth Circuit upheld the Commission's interpretation, and expressly affirmed its determination "limiting interconnection for the purposes of § 251(c)(2) to physical linkage." *Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1073 (8th Cir. 1997). Finding that this interpretation is further confirmed by § 251(g), the court held that "it is clear from the Act that Congress did not intend all access charges to move to cost-based pricing" and that it "preserves certain rate regimes already in place." *Id.* at 1072. Instead, "LECs will continue to provide exchange access to IXCs for long-distance service, and continue to receive payment, under the pre-Act regulations and rates." *Id.* at 1073. Moreover, the court held that it is "[o]bvious[]" that IXCs and CLECs use "distinct" services — the IXC "seek[s] to use the incumbent LEC's network to route long-distance calls and the newcomer LEC seeks use of the incumbent LEC's network in order to offer a competing local service" — so that applying different rates to interexchange and local traffic is not discriminatory. *Id.*

ISP-Bound Traffic. While the Internet existed at the time of the 1996 Act, it was still a relatively limited phenomenon. Congress focused on the Internet only in the context of blocking offensive material, *see* 47 U.S.C. § 230, not in the context of the Act's local competition provisions. Indeed, the more than 700-page *Local Competition Order* makes no mention of Internet service providers. In one of its few references to the Internet, the Commission noted simply that *future* "growth in Internet usage may create new peak periods" of telephone usage. *Local Competition Order* ¶ 756.

Calls to ISPs for the purpose of accessing the Internet are technically distinct from the local telephone service for which Congress intended to increase competition. An end-user customer seeking to access the Internet places a call to an ISP. That call transits the ISP's location en route to the specific Internet destinations the end user has selected. Once that initial connection has been established, however, the communication that ensues is not balanced. Instead, the vast majority of the communication that occurs over the connection flows *from* the Internet *to* the end user. Indeed, this is why Internet services — whether dial-up or broadband — are generally engineered to provide consumers with higher download speeds and slower upload speeds.

Following the issuance of the *Local Competition Order*, numerous CLECs decided to provide service to ISPs exclusively (or nearly so), rather than to provide the competing residential local telephone service that Congress sought to promote in the 1996 Act. *See ISP Remand Order* ¶ 21. As AT&T, among others, acknowledged in filings with the Commission in early 1997, the Commission had made clear "as early as 1983" that calls to an ISP are *not* local, but instead "involve *interstate* transmission," because such calls "*do not terminate* at the [I]SP's" modems, but instead continue on to "a distant data center or Internet site."[16] Numerous state commissions nevertheless held that ISP-bound traffic is "local traffic" and is therefore subject to reciprocal compensation. Almost uniformly, these state commissions determined that a call to an

[16] Comments of AT&T Corp. at 29-30, *Usage of the Public Switched Network by Information Service and Internet Service Providers*, CC Docket Nos. 96-263, *et al.* (FCC filed Mar. 24, 1997) (emphasis added) ("AT&T Comments"); Reply Comments of AT&T Corp. at 17, *Usage of the Public Switched Network by Information Service and Internet Service Providers*, CC Docket Nos. 96-263, *et al.* (FCC filed Apr. 23, 1997).

ISP is composed of two separate communications, one of which is a local call to an ISP, the other an interstate information service.

In following that approach, however, state commissions did lasting damage to local competition (while a principal beneficiary of this supposed largesse — WorldCom — squandered the money and went bankrupt). As this Commission would later hold, those state commission decisions had "distort[ed] the development of competitive markets" and had led to "classic regulatory arbitrage." *Id.*¶¶ 21, 29. The Commission found "convincing evidence" that CLECs had "targeted ISPs as customers merely to take advantage of these intercarrier payments" — offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud. *Id.* ¶¶ 2, 70 & n.134, 86. The problem was pervasive: CLECs were receiving, on average, 18 times more traffic than they were originating, "resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic." *Id.* ¶ 5. These uneconomic payments drained funds from ILECs — including the smaller ILECs that are crucial to providing universal service outside of major markets — that otherwise could have been devoted to productive investments such as broadband deployment. As the Commission found, this regime, which affirmatively discouraged CLECs from providing local voice service, was contrary to public policy and fundamentally incompatible with the pro-competitive goals of the 1996 Act. *See id.* ¶¶ 21, 70-71, 87 n.171.

***ISP Declaratory Ruling*.** In February 1999, the Commission issued its first order expressly addressing the question whether, under § 251(b)(5) and the Commission's implementing regulations, payment of reciprocal compensation was required for calls to an "ISP server in the same local calling area" as the calling party. *ISP Declaratory Ruling* ¶ 4. The Commission held that ISP-bound traffic is interexchange traffic that "do[es] not terminate at the

ISP's local server," but instead "continue[s] to the ultimate destination or destinations, specifically at a[n] Internet website that is often located in another state." *Id.* ¶ 12. The Commission reached this conclusion based on its "traditional[]" jurisdictional analysis, under which it assesses the "nature of communications by the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers." *Id.* ¶ 10. The Commission further found that, on an "end-to-end" basis, "a substantial portion of Internet traffic involves accessing interstate or foreign websites." *Id.* ¶ 18. Accordingly, the Commission concluded that ISP-bound traffic is "non-local interstate traffic" and that "the reciprocal compensation requirements of section 251(b)(5) . . . and . . . of the Commission's rules do not govern inter-carrier compensation for this traffic." *Id.* ¶ 26 n.87. The Commission did not explain, however, why its jurisdictional analysis was dispositive of the question whether ISP-bound traffic is subject to reciprocal compensation under federal law. Indeed, other than noting that it had interpreted § 251(b)(5) to apply to local traffic only, *see id.* ¶¶ 7 & n.18, 26 & n.86, the Commission never cited, let alone quoted, its reciprocal-compensation regulations; nor did it address the express terms of § 252(d)(2)(A), which provide that the reciprocal-compensation obligation extends only to traffic that "originates" on the LEC's network and "terminat[es]" on an interconnecting LEC's network; nor did it rule on CLECs' claims that ISP-bound traffic is "telephone exchange service" as defined in § 153(47) rather than "exchange access" as defined in § 153(16). Moreover, even though the harmful effects on local competition of state commission decisions requiring reciprocal compensation for ISP-bound traffic were evident at that time, the Commission offered no policy rationale for its interpretation of the Act and those regulations.

But even as the Commission correctly resolved the issue of whether ISP-bound traffic is subject to the § 251(b)(5) reciprocal-compensation obligation, the Commission went on to resolve a second issue in a contradictory manner. The Commission ruled that, even though reciprocal compensation is not required, "state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic." *Id.* ¶ 25. Congress, however, provided that, in resolving disputes in arbitration proceedings, state commissions must "ensure that [its] resolution . . . meet[s] the requirements of section 251, including the regulations prescribed by the Commission pursuant to section 251." 47 U.S.C. § 252(c)(1). The Commission did not explain how its conclusion that state commissions may require payment of reciprocal compensation for ISP-bound traffic could be squared with its simultaneous determination that neither § 251(b)(5) nor the Commission's regulations required payment of compensation for such traffic. Nor did the Commission explain why — in a portion of the order that then-Commissioner Powell correctly characterized as dicta and therefore not subject to review — it believed that an ILEC's compliance with the ESP exemption could be invoked to support an argument that the ILEC had voluntarily agreed to pay reciprocal compensation for such traffic, even though federal law imposed no such requirement. *See ISP Declaratory Ruling* ¶ 24.

Bell Atlantic v. FCC. CLECs and ILECs sought review of the *ISP Declaratory Ruling*, with CLECs challenging the Commission's conclusion that § 251(b)(5) did not require payment of reciprocal compensation for ISP-bound traffic and ILECs challenging the Commission's simultaneous conclusion that state commissions nonetheless could impose such a requirement. Confronted with an internally contradictory order, a D.C. Circuit panel consisting of Judges Williams, Sentelle, and Randolph held that the Commission "ha[d] not provided a satisfactory explanation" for its conclusion that its traditional jurisdictional analysis determines whether ISP-bound traffic is local traffic subject to § 251(b)(5). *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 8 (D.C. Cir. 2000). The court also questioned whether ISP-bound traffic is "telephone exchange service" or "exchange access," although it noted that any Commission interpretation of these ambiguous terms with respect to ISP-bound traffic would receive judicial deference. *Id.* at 8-9. The court therefore vacated and remanded the *ISP Declaratory Ruling*.[17]

The D.C. Circuit did *not* take issue, however, with the FCC's end-to-end analysis of ISP-bound traffic. On the contrary, it found that there is "*no dispute* that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate." *Id.* at 5. Nor did the court intimate, let alone hold, that ISP-bound traffic *is* "local traffic." Indeed, Judges Williams and Sentelle subsequently rebuked the CLECs for claiming that the court had reached such a determination: during oral argument on appeal of the *ISP Remand Order*, those judges, both of whom were also on the *Bell Atlantic* panel, pointedly noted that the *Bell Atlantic* court was "rigorously agnostic" on the question whether § 251(b)(5) requires payment of reciprocal compensation for ISP-bound traffic. Transcript of Oral Argument at 10-11, *WorldCom, Inc. v. FCC*, Nos. 01-1218, *et al.* (D.C. Cir. argued Feb. 12, 2002) ("I'm at a loss as to how you can pass the straight face test with the notion that we've given some strong signal that this is a local call."); *see also* Transcript of Oral Argument at 14, *WorldCom, Inc. v. FCC*, No. 00-1002 (D.C. Cir. Feb. 21, 2001) (*Bell Atlantic* held only that FCC's decision "w[as] not adequately supported").[18]

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[17] In light of its resolution of the CLECs' challenge, the court found no need to address the ILECs' arguments. *See Bell Atlantic*, 206 F.3d at 9.

[18] Although the D.C. Circuit stated, at the end of a paragraph summarizing WorldCom's claims, that calls to ISPs "appear to fit" the Commission's definition of "termination," the court was only continuing to paraphrase WorldCom's argument. *Compare Bell Atlantic*, 206 F.3d at 6

***ISP Remand Order*.** On remand from the D.C. Circuit's decision, the Commission reiterated, albeit on a different statutory theory, that an ISP-bound call is not subject to reciprocal compensation under § 251(b)(5). Despite the fact that no party had challenged the Commission's earlier determination that § 251(b)(5) is limited to local traffic, the Commission now concluded, based on the provision's use of the term "telecommunications," that, "*[u]nless subject to further limitation*, section 251(b)(5) would require reciprocal compensation for transport and termination of *all* telecommunications traffic [that] . . . a local exchange carrier exchanges . . . with another carrier." *ISP Remand Order* ¶¶ 31-32, 46 (emphasis added).

The Commission found one such "further limitation" that it viewed as determinative in § 251(g), and it therefore had no occasion to consider whether the Act also contained other limitations. That section, the Commission held, "explicitly exempts certain telecommunications services from the reciprocal compensation obligations" imposed by § 251(b)(5). *Id.* ¶ 32. The services exempted from § 251(b)(5), according to the Commission, were those specifically mentioned in § 251(g) — "exchange access, information access, and exchange services for such access." *Id.* ¶ 34. As explained above, § 251(g) preserved both the pre-existing "interconnection restrictions and obligations (including receipt of compensation)" with respect to such services, as well as the Commission's authority to "supersede[] by regulation[]" those pre-existing obligations. 47 U.S.C. § 251(g). The Commission further held that ISP-bound traffic is a type of

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("In attacking the Commission's classification of ISP-bound calls . . . , MCI WorldCom notes that under 47 CFR § 51.701(b)(1) 'telecommunications traffic' is local if it 'originates and terminates within a local service area.' . . . Calls to ISPs appear to fit th[e Commission's] definition [of termination]: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'") *with* Brief of Petitioner MCI WorldCom, Inc. at 36 (Sept. 2, 1999), *Bell Atlantic Tel Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (No. 99-1094) ("Calls to ISPs fall squarely within the Commission's definition of termination because they are 'switched' by the local carrier whose customer is the ISP and 'delivered' to the ISP's local premises.").

access traffic — specifically, information access — that consists of a continuous communication that "travel[s] to points — both interstate and intrastate — beyond the local exchange." *ISP Remand Order* ¶¶ 37, 44. In reaching that conclusion, the Commission again rejected CLECs' attempts to split ISP-bound traffic into two separate communications, one of which is a local call. *See id.* ¶ 44 & n.82 (rejecting CLECs' argument that "information access" excludes "basic telecommunications links used to provide enhanced service providers with access to the LEC network," which instead are an intraexchange service).

Indeed, the Commission reaffirmed that, "when viewed on an end-to-end basis," ISP-bound calls are jurisdictionally interstate, because they "permit the dial-up Internet user to communicate directly with some distant site or party (other than the ISP) that the caller has specified." *Id.* ¶¶ 58-59; *see id.* ¶ 59 ("[t]he 'communication' taking place is between the dial-up customer and the global computer network of web content," not "with ISP modems"). For this reason, an ISP-bound call is not, as CLECs had claimed, "simply a local call from a consumer to a machine," nor is it "really like a call to a local business — such as a pizza delivery firm . . . — that then uses the telephone to order wares to meet the [caller's] need." *Id.* ¶¶ 63, 64 (internal quotation marks omitted). Therefore, the Commission held that compensation for such traffic is governed by § 201. *See id.* ¶¶ 42, 44, 52.

As noted above, the Commission found that state commission decisions requiring payment of reciprocal compensation for ISP-bound calls had led to uneconomic regulatory arbitrage. Based on that record, the Commission determined that "a bill and keep approach" "is likely to be more economically efficient than recovering these costs from originating carriers," because it "is likely to send appropriate market signals and substantially eliminate existing opportunities for regulatory arbitrage." *Id.* ¶ 67. Recognizing a "need for immediate action with respect to ISP-bound traffic," *id.* ¶ 7, the Commission adopted, under § 201, an interim compensation regime for such traffic, acceding to CLEC requests that the Commission "avoid a 'flash cut' to a new compensation regime," *id.* ¶ 77. The Commission's "primary goal," however, remained "limit[ing], if not end[ing], the opportunity for regulatory arbitrage" created by the prevailing, state-commission established, reciprocal-compensation requirements. *Id.*

The Commission's interim compensation regime, designed to effect a "standstill on any expansion" of state commission decisions requiring reciprocal compensation for ISP-bound traffic, established declining caps on the rates for such traffic. *Id.* ¶¶ 78, 80-81. The Commission did not attempt to determine the costs, if any, that carriers incurred in delivering ISP-bound traffic. It did, however, make an express determination that, to the extent a carrier's costs of delivering this traffic exceeded the caps, it could "recover those amounts from its own end-users." *Id.* ¶ 80 & n.151. The Commission also held that the rate caps "have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps we adopt here or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic)." *Id.* ¶ 80. To obtain the benefits of these transitional steps, however, the Commission imposed a cost on ILECs: for *all CLECs* in a state, they were required to accept payment for transporting and terminating traffic subject to § 251(b)(5) under the same rate cap rule the Commission established under § 201 for ISP-bound traffic. *See id.* ¶ 89 & n.179. In other words, to prevent some CLECs from continuing to take advantage of the regulatory arbitrage opportunities presented by ISP-bound traffic, incumbents had to agree to lower payments on traffic that had always been subject to § 251(b)(5).

WorldCom v. FCC. On review, a D.C. Circuit panel composed of Judges Williams, Sentelle, and Tatel rejected the Commission's theory that § 251(g) excludes ISP-bound traffic from the § 251(b)(5) reciprocal-compensation obligation, finding that § 251(g) "is not susceptible to the Commission's reading." *WorldCom v. FCC*, 288 F.3d 429, 432 (D.C. Cir.), *cert. denied*, 538 U.S. 1012 (2002). For that reason alone, the court "remand[ed] the case to the Commission for further proceedings." *Id.* at 434. The D.C. Circuit "ma[d]e no further determinations," even taking pains to identify some of the issues that it was *not* resolving. In addition to emphasizing at oral argument that the court had *not* suggested in its prior order either that ISP-bound traffic was a local call or that § 251(b)(5) requires payment of reciprocal compensation for such traffic, the court's order carefully noted that:

> [W]e do not decide whether handling calls to ISPs constitutes "telephone exchange service" or "exchange access" . . . or neither, or whether those terms cover the universe to which such calls might belong. Nor do we decide the scope of the "telecommunications" covered by § 251(b)(5). Nor do we decide whether the Commission may adopt bill-and-keep for ISP-bound calls pursuant to § 251(b)(5) . . . . Indeed these are only samples of the issues we do not decide, which are in fact all issues other than whether § 251(g) provided the authority claimed by the Commission for not applying § 251(b)(5).

Id. The court was sympathetic to the Commission's policy determinations, however, noting that, because "ISPs typically generate large volumes of one-way traffic in their direction, the old system attracted LECs that entered the business simply to serve ISPs, making enough money from reciprocal compensation to pay their ISP customers for the privilege of completing the calls." *Id.* at 431.

Moreover, the court recognized that "there may well be other legal bases for adopting the rules chosen by the Commission for compensation between . . . LECs in calls to ISPs." *Id.* at 430; *see id.* at 434 ("there is plainly a non-trivial likelihood that the Commission has authority to elect [a bill-and-keep] system" for ISP-bound traffic). For this reason, the court expressly refused — both in its initial decision and in denying CLEC petitions for rehearing — to vacate the rules promulgated in the *ISP Remand Order*, under which calls to ISPs are not subject to reciprocal compensation. *See id.* at 434; Order, *WorldCom, Inc. v. FCC*, Nos. 01-1218, *et al.* (D.C. Cir. Sept. 25, 2002). As a result, that order and those regulations remain binding federal law. *See, e.g., National Lime Ass'n v. EPA*, 233 F.3d 625, 635 (D.C. Cir. 2000) (regulations that are remanded but not vacated are "le[ft] . . . in place during remand"). The Commission itself confirmed that, because the "court did not vacate" the *ISP Remand Order*, "our rules remain in effect" and "ISP-bound traffic is not subject to the reciprocal compensation provisions of section 251(b)(5) and 252(d)(2)."[19] And every federal court[20] and every state commission[21] to address the issue has agreed.

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[19] Memorandum Opinion and Order, *Joint Application by BellSouth Corp., et al., for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, 17 FCC Rcd 9018, ¶ 272 (2002) ("*BellSouth 271 Order*").

[20] *See Pacific Bell v. Pac-West Telecomm, Inc.*, 325 F.3d 1114, 1122, 1125 (9th Cir. 2003) ("the [ISP] Remand Order remains in effect pending the FCC's proceedings on remand"); *Verizon Maryland Inc. v. RCN Telecom Servs., Inc.*, 248 F. Supp. 2d 468, 484 n.6 (D. Md. 2003); *Wisconsin Bell, Inc. v. Bie*, 216 F. Supp. 2d 873, 878 (W.D. Wis. 2002).

[21] *See* Phase II Opinion and Order, Docket No. T-00000A-00-0194, Decision No. 64922, 2002 Ariz. PUC LEXIS 11, at *127 (June 12, 2002); Opinion Adopting Final Arbitrator's Report with Modification, Application 01-11-045, *et al.*, Decision 02-06-076, 2002 Cal. PUC LEXIS 319, at *13 & n.2 (June 27, 2002); Commission Decision Regarding OSS, Section 272, Public Interest, Track A, Change Management Process, and Data Reconciliation and Commission Decision Regarding the Commission's Recommendation to the Federal Communications Commission Concerning Qwest Corp.'s Compliance with Section 271, Docket No. 02M-260T, Decision No. C02-718, 2002 Colo. PUC LEXIS 636, at *51-*53 (June 13, 2002); Final Order on Petition for Arbitration, Docket No. 020412-TP, Order No. PSC-03-0762-FOF-TP, at 42 (Fla. PSC June 25, 2003); Order, No. 01-0427, 2002 Ill. PUC LEXIS 703, at *18-*19, ¶ 27 (July 24, 2002); Opinion, Case No. 8745, Order No. 77913, 219 P.U.R.4th 1 at n.123 (Md. PSC July 17, 2002); Order on Remand, D.T.E. 97-116-G, 2002 Mass. PUC LEXIS 62, at *6-*7 (Dec. 20, 2002); Order on Motion for Reconsideration and Pending Motions, Util. Div. Docket No. D2000.1.14, Order No. 6225i, 2003 Mont. PUC LEXIS 22, at *32-*33, ¶ 47 (Apr. 9, 2003); Opinion, Application No. C-2780, 2003 Neb. PUC LEXIS 48, at *10, ¶ 22 (Apr. 22, 2003); Final Order, DT 00-223 & 00-054, Order No. 24,080, 2002 N.H. PUC LEXIS 165, at *43 (Oct. 28, 2002); Recommended Arbitration Order, Docket No. P-561, Sub 19, 2003 N.C. PUC LEXIS 674, at *80-*81 (June 11, 2003); Finding and Order, Case No. 01-08-TP-ATA, 2002 Ohio PUC LEXIS 684, at *3-*4, ¶¶ 5-6 (July 23, 2002); Order, UM 1058, Order No. 03-329, 2003 Ore. PUC LEXIS 213, at *23 (May 27, 2003); Opinion and Order, A-310752F700 (Pa. PUC Aug. 30, 2002); Final Arbitration Decision and Order, Docket No. 3437, 2003 R.I. PUC LEXIS 9, at *11 (Jan. 24, 2003); Order on Arbitration, Docket No. 2002-181-C, Order No. 2002-619, 2002 S.C.

ANALYSIS

The Commission has consistently and correctly held that ISP-bound traffic is interexchange, interstate access traffic and therefore that § 251(b)(5) does not require payment of reciprocal compensation for such traffic. But in neither of the orders directly addressing this question did the Commission provide a comprehensive and holistic supporting analysis. That is, to the extent those orders addressed the relevant interpretive materials — the text and structure of the 1996 Act, its legislative history, the background against which it was enacted, the Commission's implementing regulations, its precedents applying intercarrier compensation based on the jurisdictional nature of traffic, and the significant, harmful effects to local competition of requiring reciprocal compensation for ISP-bound traffic — they did so only in part and on a piecemeal basis. The D.C. Circuit found those prior orders wanting precisely because the Commission's analysis was incomplete — and, in one case, because it was also internally contradictory. But the court also expressly left open the basic statutory questions that the Commission must now resolve — including the pivotal question of "the scope of the 'telecommunications' covered by § 251(b)(5)." *WorldCom*, 288 F.3d at 434.

I. ISP-BOUND TRAFFIC IS NOT SUBJECT TO RECIPROCAL COMPENSATION UNDER 47 U.S.C. §§ 251(B)(5) AND 252(D)(2)

A. Sections 251(b)(5) and 252(d)(2) Exclude ISP-Bound Traffic Because It Does Not Both Originate on One LEC's Network and Terminate on Another LEC's Network Within the Same Local Calling Area

Section 251(b)(5) requires local exchange carriers to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." "Telecommunications"

PUC LEXIS 9, at *24-*25 (Aug. 30, 2002); Opinion, Docket No. 6742, 2002 Vt. PUC LEXIS 272, at *17, *32 n.42 (Dec. 26, 2002); Seventh Supplemental Order: Affirming Arbitrator's Report and Decision, Docket No. UT-023043, 2003 Wash. UTC LEXIS 76, at *4 (Feb. 28, 2003); Order to Rescind, No. 05-T1-283, 2003 Wisc. PUC LEXIS 35, at *4-*5 (Jan. 24, 2003).

is defined in the Act to mean "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43). In the *ISP Remand Order*, the Commission focused on the Act's broad definition of "telecommunications," explaining that, "[u]nless subject to further limitation," § 251(b)(5) would apply "whenever a local exchange carrier exchanges telecommunications traffic with another carrier." *ISP Remand Order* ¶ 32. Because the Commission found such a "further limitation" in the terms of § 251(g), "the focus of [its] inquiry [was] on the universe of traffic that falls within subsection (g) and *not* the universe of traffic that falls within subsection (b)(5)." *Id.* ¶ 34. The Commission went on to find that § 251(g) exempted from § 251(b)(5) "'exchange access, information access, and exchange services for such access' provided to IXCs and information service providers," and that "ISP-bound traffic falls within at least one of the three enumerated categories in subsection (g)." *Id.* ¶¶ 34, 36.

Having determined that § 251(g) removed ISP-bound traffic from § 251(b)(5)'s reciprocal-compensation obligation, the Commission had no occasion in the *ISP Remand Order* to consider whether any *other* statutory text might similarly restrict "the universe of traffic that falls within subsection (b)(5)." *Id.* ¶ 34. In particular, the Commission expressly "refrain[ed] from generically describing traffic as 'local' traffic," in part "because the term 'local,' not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g)." *Id.* But the Commission did not *repudiate* the analysis on which it had relied in the *Local Competition Order*; rather, it simply had no reason to revisit that analysis in light of the alternative approach it followed in the *ISP Remand Order*.

Now that the D.C. Circuit has rejected the Commission's reading of § 251(g), the Commission must consider whether *other* portions of the statute confine "the universe of traffic that falls within subsection (b)(5)." That inquiry leads inevitably to the conclusion — based on the Act's text, structure, and legislative history — that § 251(b)(5) applies only to traffic that originates on the network of one local exchange carrier and terminates on the network of another local exchange carrier within the same local calling area. Because ISP-bound traffic does not fall within that category, it is not subject to reciprocal compensation under § 251(b)(5).

1. Sections 251(b)(5) and 252(d)(2) apply only to traffic that originates on the network facilities of one local exchange carrier and terminates on the network facilities of an interconnecting local exchange carrier within the same local calling area.

a. Section 251(b)(5) is one of five duties that apply to "[e]ach local exchange carrier," 47 U.S.C. § 251(b), not just to incumbent LECs. By its nature, "reciprocal compensation" must therefore apply to "telecommunications" exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs. Furthermore, the statute makes clear that the provision applies only to traffic that originates on the facilities of one interconnecting LEC and terminates on the facilities of the other LEC. Section 252(d)(2)(A) provides that "the terms and conditions for reciprocal compensation" must "provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and *termination* on each carrier's network facilities of calls that *originate* on the network facilities of the other carrier," and must "determine such costs on the basis of a reasonable approximation of the additional costs of *terminating* such calls," 47 U.S.C. § 252(d)(2)(A) (emphasis added).

The only permissible reading of these two provisions is that they apply only to traffic that originates on the facilities of one carrier and terminates on the facilities of a second carrier within the same local calling area. Any other reading would either contradict one or more of the provisions or lead to absurd results. Section 251(b)(5) cannot apply to traffic exchanged between LECs and non-LECs, because the provision applies by its terms only to LECs. Section 251(b)(5) cannot apply to traffic that a third party delivers to one LEC, which then passes the traffic to a second LEC for termination, because such traffic is not originated on the network of the first LEC. Section 251(b)(5) cannot apply to traffic that is originated by one LEC, passed to a second LEC, and then delivered to an interexchange carrier, because such traffic — although originated by one LEC — is not terminated by the second. And reciprocal compensation cannot apply to traffic that is originated by one LEC, passed to an IXC, then terminated by a LEC located in a distant local calling area, because any such obligation would require a practically infinite number of reciprocal-compensation arrangements among LECs in different areas, an absurd result that Congress cannot be deemed to have intended.

b. The historical background, the legislative history, and the structure of the 1996 Act confirm that § 251(b)(5) is limited to local telecommunications.

As explained above, Congress enacted the 1996 Act against a background of widespread competition for interexchange calls, but nascent (if any) competition for local calls. This Commission and the state commissions had well-established regimes governing the compensation due to the LECs that originated or terminated interexchange calls. As the state commissions that were involved in developing local competition before passage of the 1996 Act recognized, the advent of local competition required development of new compensation rules for local exchange calls, rather than revision of the existing access-charge rules.[22]

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[22] *See supra* notes 7-10 (citing decisions).

The legislative history is clear that Congress intended to leave intact the existing access-charge regimes. *See* H.R. Conf. Rep. No. 104-458, at 117 (1996) ("nothing in th[e] section [of the Senate bill that became 47 U.S.C. § 251] is intended to affect the Commission's access charge rules"); S. Rep. No. 104-23, at 22 (1995) (same). And the Commission has held that "Congress did not intend to disrupt the[] pre-existing" access-charge regimes. *ISP Remand Order* ¶ 37. The new reciprocal-compensation obligation established in the 1996 Act, therefore, must be understood to apply to local — *i.e.*, non-access — traffic only.

The terms and structure of the 1996 Act reinforces this conclusion. As noted, the obligation imposed by § 251(b)(5) applies to "[e]ach *local* exchange carrier." 47 U.S.C. § 251(b) (emphasis added). Both § 251(b)(5) and the related § 252(d)(2) refer to the "transport *and termination*" performed by the other carrier, with the latter section making clear that the calls at issue must "*terminat[e]* on [the second] carrier's network facilities." *Id.* §§ 251(b)(5), 252(d)(2)(A)(i) (emphasis added). Finally, reciprocal compensation is part of the competitive checklist, compliance with which is intended to ensure that the "*local* market is . . . open to competition." *Michigan 271 Order*[23] ¶ 18 (emphasis added).

Other provisions also reflect the distinction between local exchange traffic on the one hand and exchange access traffic on the other. For example, § 251(c)(2) makes clear that Congress anticipated that two distinct types of traffic would be exchanged between interconnecting local exchange carriers — namely, "telephone exchange service and exchange access." And, lest the express terms of § 251(b)(5) and § 252(d)(2) leave any doubt, Congress provided still further confirmation that only the first of these categories was subject to reciprocal

[23] Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan,* 12 FCC Rcd 20543 (1997) ("*Michigan 271 Order*").

compensation at state-set rates. Congress did so both in § 251(g) — where it confirmed that both the pre-existing exchange access regime (and any superseding rules adopted by the Commission) were not affected by the 1996 Act — and in § 251(i) — where it confirmed that the Commission's authority over interstate traffic likewise was not affected.

c. For all of these reasons, the Commission correctly concluded in the *Local Competition Order* that § 251(b)(5) "is intended for a situation in which two carriers collaborate to complete a local call." *Local Competition Order* ¶ 1034. As noted above, no party sought review of that interpretation. In addition, the Eighth Circuit upheld the Commission's determination that "access charges are not affected by our rules implementing section 251(c)(2)," which obligates incumbent LECs to permit other carriers to interconnect for, among other things, "the transmission and routing of . . . exchange access." *Id.* ¶¶ 173, 176; 47 U.S.C. § 251(c)(2)(A). As that court held, Congress preserved the existing access charge regime, so that LECs would "continue to receive payment, under the pre-Act regulations and rates." *Competitive Telecomms.*, 117 F.3d at 1073.

Nothing in *Bell Atlantic* called into question the Commission's interpretation of § 251(b)(5). Indeed, although both ILECs and CLECs challenged the Commission's ruling, no party disputed that the dispositive question under § 251(b)(5) and the Commission's regulations was whether ISP-bound traffic is *local* traffic. Nor did the D.C. Circuit question the Commission's determination in the *Local Competition Order* that § 251(b)(5) applies only to *local* traffic. There is thus no judicial impediment to the Commission's readopting the interpretation that it correctly embraced in the *Local Competition Order*.

Nor was there any basis for the Commission's later suggestion that its "use of the phrase 'local traffic' [in the *Local Competition Order*] created unnecessary ambiguities." *ISP Remand*

Order ¶ 46. In the *Local Competition Order*, as in the regulations it promulgated, the Commission clearly stated that reciprocal compensation "appl[ies] only to traffic that originates and terminates within a local area." *Local Competition Order* ¶ 1034; *see* 47 C.F.R. §§ 51.701(b)(1), 51.703(a) (1996) (requiring carriers to provide compensation only for the "transport and termination of local telecommunications traffic," defined as traffic that "originates and terminates within a local service area established by the state commission"). That order and the regulations could *not* "be interpreted as [including] either traffic subject to local *rates* or traffic that is *jurisdictionally* intrastate." *ISP Remand Order* ¶ 45.[24] Indeed, neither the order nor the rules made reference to how a call is billed to the calling party. As has long been understood, an interexchange call may be billed as local to the calling party because the *called* party may have purchased a toll (or "toll substitution") service. For example, AT&T has for many years offered interLATA foreign exchange service, in which a customer located in a distant state can establish a "local" presence for making and receiving calls. Such a call plainly does not originate and terminate within the same local calling area, though it is billed to the calling party as though it did. In any event, the FCC can eliminate any potential ambiguities going forward by stating in straightforward terms that § 251(b)(5) reaches only "local exchange traffic" (or, to use the statutory term, "telephone exchange service") traffic and that such traffic must originate and terminate within the same local exchange.

Finally, any order holding that ISP-bound traffic is subject to reciprocal compensation based on a conclusion that § 251(b)(5) covers all traffic a LEC exchanges with another carrier, regardless of its origination or termination points, would be legally indefensible. For the reasons

[24] Even if there were any ambiguity in the Commission's prior rules, the Commission gets great deference in its interpretation of its own rules, as long as its interpretation is reasonable.

discussed above, any such reading of the statute would be impossible to square with the statutory text, structure, and legislative history. Indeed, for any such interpretation to survive judicial review, the Commission would have to convince a court that Congress intended a radical transformation — rather than the preservation — of pre-existing access-charge regimes. First, Congress would have to be understood to have authorized (if not compelled[25]) the Commission to eliminate the compensation an originating carrier *receives* for interexchange calls and, instead, to require the originating carrier to *pay* another carrier for terminating the call. That, of course, would be flatly contrary to Congress's stated intent and to the terms of § 251(g). Second, Congress would have to be understood to have transferred authority over interstate access charges to state commissions, which have authority to arbitrate disputes concerning the requirements of § 251(b)(5). And that would be flatly contrary to the terms of § 251(i), which provides that "[n]othing in this section shall be construed *to limit or otherwise affect* the Commission's authority under section 201" (emphasis added). In short, there is no basis to suggest that Congress, in opening up *local* markets to competition, intended such disruption to existing competition in *interexchange* markets.

2. ISP-bound traffic does not terminate on the network of a local exchange carrier within the same local calling area in which it originated.

To qualify for reciprocal compensation under §§ 251(b)(5) and 252(d)(2), as explained above, traffic must originate and terminate within the same local calling area and on the network facilities of a local exchange carrier. There is no dispute that ISP-bound traffic "originates" at the calling party's premises; the determinative question, therefore, is where this traffic

[25] *See* 47 U.S.C. § 251(d)(1) ("Within 6 months . . . the Commission shall complete all actions necessary to establish regulations to implement the requirements of . . . section [251]."); *see also id.* § 251(g) (providing that the existing access charge rules can be "explicitly superseded by regulations prescribed by the Commission").

"terminates." As the Commission has already held repeatedly, ISP-bound traffic does not meet the statute's standard because it does not terminate at the ISP's premises. *See* Memorandum Opinion and Order, *GTE Tel. Operating Cos.; GTOC Tariff No. 1; GTOC Transmittal No. 1148*, 13 FCC Rcd 22466, ¶ 19 (1998) (ISP-bound calls "do not terminate at the ISP[] . . . but continue to the ultimate destination or destinations, very often at a distant Internet website accessed by the end user"); *Advanced Services Remand Order*[26] ¶ 16 ("ISP-bound traffic does not originate and terminate within an exchange").

The Commission held in the *ISP Remand Order* that "[m]ost Internet-bound traffic traveling between a LEC's subscriber and an ISP is *indisputably interstate in nature* when viewed on an end-to-end basis." *ISP Remand Order* ¶ 58 (emphasis added). Because ISPs "provide services that permit the dial-up Internet user to communicate directly with some distant site or party (*other than the ISP*) that the caller has specified," *id.* ¶ 59 (emphasis added), the ISP is not the "called party[]" and calls to an ISP do not "terminat[e]" at the ISP's premises, 47 C.F.R. § 51.701(d) (defining "termination" as "switching of telecommunications traffic . . . and delivery of such traffic *to the called party's premises*") (emphasis added).[27]

[26] Order on Remand, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd 385, ¶ 16 (1999) ("*Advanced Services Remand Order*"), *vacated and remanded sub nom. WorldCom, Inc. v. FCC*, 246 F.3d 690 (D.C. Cir. 2001).

[27] Although the *Bell Atlantic* court seemed open to the possibility that an ISP-bound call does terminate at the ISP's premises, its statement was the product of a misimpression left by the Commission's brief in that case. The court quoted the Commission's brief as follows: "Even if, from the perspective of the *end user* as customer, the telecommunications portion of an Internet call 'terminates' at the ISP's server (and information service begins), the remaining portion of the call would continue to constitute telecommunications from the perspective of the *ISP* as customer." *Bell Atlantic*, 206 F.3d at 7 (quoting FCC Br. at 41). The court understood the FCC to be arguing that "the ISP *originates further telecommunications*." *Id.* (emphasis added). On the basis of that understanding, the court said that the ISP's origination of further telecommunications "does not imply that the original telecommunication does not 'terminate' at the ISP." *Id.*; *see also id.* at 5 (calls to ISPs are "not quite long-distance, because the *subsequent*

The Commission's conclusion that ISP-bound calls transit the ISP's location on the way to the Internet accords with its long-standing holding — consistently reiterated over the past 20 years — that "enhanced service providers . . . obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location." *MTS and WATS Market Structure* ¶ 78; *see ISP Remand Order* ¶ 55 & nn.105-07 (citing subsequent decisions). In light of this precedent, as AT&T explained in filings with the Commission in 1997, the industry had long understood that calls to an ISP are *not* local and "*do not terminate* at the [I]SP's" modems.[28]

As the Commission noted in the *ISP Remand Order* (¶ 62), *BellSouth Memory Call*[29] illustrates the principle that the point of termination of any communication — whether a basic telecommunications service or an enhanced service — must be determined by reference to its actual end points, without regard to intermediate switching points. The Commission there refused to divide a single communication into an interstate call to "the intended recipient's location" and a purely intrastate communication "forwarding the call to the voice mail apparatus and service." *BellSouth Memory Call* ¶ 8. Instead, the Commission found that, "[w]hen the caller [to voice mail service] is out-of-state, there is a continuous path of communications across

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communication is not really a continuation, in the conventional sense, of the initial call to the ISP") (emphasis added). As noted above, however, the court has since made clear on more than one occasion that it did *not* intend to signal that ISP-bound calls are local but instead left that issue open for the Commission to address. In fact, as the Commission's prior decisions make clear, and as it clarified in the *ISP Remand Order*, there is no doubt that a call to an Internet website *is* a single, continuous communication, that the call does *not* terminate at the ISP's server, and that the ISP does *not* "originate further telecommunications." The Commission should expressly reiterate these points and should repudiate the misimpression left by its brief in *Bell Atlantic*.

[28] AT&T Comments at 29-30.

[29] Memorandum Opinion and Order, *Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp.*, 7 FCC Rcd 1619 (1992) ("*BellSouth Memory Call*").

state lines between the caller and the voice mail service, just as there is when a traditional out-of-state long distance voice telephone call is forwarded by the local switch to another location in the state." *Id.* ¶ 9. Similarly here, there is a continuous path of communications between the end user and the distant Internet site.

In addition, ISP-bound traffic, as the Commission held, is "analogous . . . to long distance calling service" — in particular, to Feature Group A service. *ISP Remand Order* ¶ 60. In a Feature Group A arrangement, the end user dials a seven- or ten-digit "local" access number and is connected to an IXC. The IXC returns a second dial tone to the end user, at which point the end user enters the telephone number of the distant end user, and the call is connected. In that situation, it makes little sense to say that the end user "calls" the IXC or that the call "terminates" at the IXC; rather, the end user uses the IXC to call the distant end user. Despite the appearance of a locally dialed number, and the additional interaction between the caller and the IXC, there is no dispute that this is a single call that terminates only when it reaches its ultimate destination. *See id.* ¶¶ 60-61.

For all these reasons, ISP-bound traffic does not originate and terminate within the same local calling area, and cannot be said to terminate on a local exchange carrier's network, as required by §§ 251(b)(5) and 252(d)(2). The local exchange carrier's facilities end at the ISP's premises. Because ISP-bound calls "do *not* terminate at the ISP's local server . . . but continue to the ultimate destination or destinations, specifically at a Internet website that is often located in another state," *ISP Declaratory Ruling* ¶ 12, such calls do not terminate on the LEC's network facilities.

3. The D.C. Circuit's prior decisions leave the Commission ample room to adopt this analysis.

Nothing in the D.C. Circuit's decision in *Bell Atlantic* undermines this analysis. The panel (consisting of Judges Williams, Sentelle, and Randolph) identified two areas where the Commission's *ISP Declaratory Ruling* contained insufficient analysis. First, the court sought additional explanation for why the Commission's traditional jurisdictional analysis controls whether ISP-bound traffic is subject to § 251(b)(5). *Bell Atlantic*, 206 F.3d at 9. Second, the court sought an answer to whether ISP-bound traffic is "telephone exchange service" or "exchange access," as those terms are defined in the Act. *See id.* at 8-9. The court did not pre-judge either of those questions — in *Bell Atlantic* or in its subsequent decision in *WorldCom*, *see* 288 F.3d at 434[30] — and the Commission, as part of a comprehensive discussion, can readily provide the analysis that the court found lacking in the prior orders.

a. Though its analysis in the *ISP Declaratory Ruling* was fundamentally sound, the Commission neglected to tie that analysis to the controlling terms of the statute or the implementing regulations. The Commission could (and should) have linked its jurisdictional discussion to the statute's focus on a call's "termination" point. *See* 47 U.S.C. §§ 251(b)(5), 252(d)(2)(A). The Commission could have explained, for example, that the end-to-end analysis on which it had consistently relied in the past for both jurisdictional and non-jurisdictional purposes was an appropriate mechanism for determining as well whether a call terminates on the network of a local exchange carrier, as required by §§ 251(b)(5) and 252(d)(2)(A), or continues

[30] As explained above, the court has made clear that it was "rigorously agnostic" in *Bell Atlantic* on whether ISP-bound traffic is subject to reciprocal compensation and that it had not intended to "signal that this is a local call." *See supra* p. 18. Likewise, the Court made clear in its *WorldCom* decision that it was not deciding, among other things, whether ISP-bound calls are "telephone exchange service" or "exchange access," or whether those call are "covered by § 251(b)(5)." *Id.*

on to some other point beyond the local exchange carrier's network. In the absence of that explanation, the court found itself simply confused by the Commission's reliance on a jurisdictional analysis that was not self-evidently tied directly to the relevant statutory inquiry. It accordingly vacated the *ISP Declaratory Ruling* precisely because, in its view, the Commission had not "provide[d] an explanation why this [jurisdictional] inquiry is relevant to discerning whether a call to an ISP" is subject to reciprocal compensation. *Bell Atlantic*, 206 F.3d at 5. The Commission can easily remedy *this* failure by taking care to explain the statutory basis for its end-to-end analysis.

The D.C. Circuit was also concerned that "the extension of 'end-to-end' analysis from jurisdictional purposes to the present context yields intuitively backwards results." *Id.* at 6. Recognizing the internal contradiction in the *ISP Declaratory Ruling*, the court noted that, while the federal reciprocal compensation regime would apply only to "[c]alls that are jurisdictionally *intra*state," "*inter*state" ISP-bound traffic was "left to potential state regulation," as a result of the Commission's determination that state commissions, in arbitration proceedings, could require carriers to pay compensation for ISP-bound traffic. *Id.* The anomaly, however, was the Commission's authorization to state commissions to impose compensation obligations inconsistent with federal law, not the Commission's use of its jurisdictional analysis to determine intercarrier compensation.

Indeed, the Commission has traditionally used its end-to-end analysis for purposes of *both* jurisdiction *and* compensation, a crucial point that it had failed to explain in the *ISP Declaratory Ruling*. For example, even though a Feature Group A call is initiated by dialing a "local" telephone number, when Feature Group A is used to make an interstate call, such calls are both jurisdictionally interstate and subject to interstate access charges. Therefore, when a customer of one LEC dialed a "local" number to reach a Feature Group A customer of another LEC, neither paid compensation to the other. Instead, both jointly originated the Feature Group A call and shared in the access charges paid by the IXC. *See, e.g., Access Charge Order* ¶¶ 21-26.

Nor is Feature Group A the only example where the Commission's end-to-end analysis controlled the jurisdiction *and* the appropriate intercarrier compensation. In *Teleconnect*,[31] for example, the Commission rejected the argument that a credit card call should be treated, *for purposes of assessing access charges*, as a local call from the card user to an IXC followed by a second call. *See Teleconnect* ¶¶ 21-24. In denying reconsideration, the Commission found no "legal significance" in an "attempt to distinguish the so-called 'jurisdictional' nature of a call from its status for 'billing' purposes." *Teleconnect Order on Reconsideration* ¶ 12.

Likewise, in *AT&T Corp. v. Bell Atlantic-Pennsylvania*, the Commission ruled that an interLATA foreign exchange ("FX") service is subject to access charges. *See* Memorandum Opinion and Order, *AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, ¶¶ 71, 80 (1998), *recon. denied*, 15 FCC Rcd 7467 (2000). In an interLATA FX arrangement, an airline with a reservation office in Atlanta could provide customers in Washington, D.C. a locally rated number, but all calls would still be routed to Atlanta. Even though the originating LEC would bill such calls to its customer as local calls, the Commission required the IXC to pay access charges based on the end points of the interLATA call. The Commission reached the same result in that order with respect to call forwarding, finding that, because "call forwarding is jurisdictionally mixed, . . . both interstate and local charges may apply," even though "LECs and

[31] Memorandum Opinion and Order, *Teleconnect Co. v. Bell Tel. Co.*, 6 FCC Rcd 5202, 5206 (1991) ("*Teleconnect*"), *recon. denied*, 10 FCC Rcd 1626 (1995) ("*Teleconnect Order on Reconsideration*").

. . . the IXCs treat the forwarded part of the call as a local or intraLATA toll call for bookkeeping and billing purposes." *Id.* ¶ 47.

These orders thus provide the explanation that the D.C. Circuit believed was lacking from the *ISP Declaratory Ruling* — they demonstrate the connection between the Commission's jurisdictional determinations and the application of its compensation rules. And, contrary to the court's suggestion, the so-called "ESP exemption" is not "something of an embarrassment" to a determination that calls to ISPs are not subject to reciprocal compensation because they are jurisdictionally interstate. *Bell Atlantic*, 206 F.3d at 8. On the contrary, as the Commission explained in the *ISP Remand Order*, it has consistently held that "the link LECs provide to connect subscribers with ESPs is an *interstate access service*." *ISP Remand Order* ¶ 55 (emphasis added); *see also id.* ¶ 57. To promote the development of enhanced services, the Commission has allowed ESPs "*the option* of purchasing interstate access services on a flat-rated basis from intrastate local business tariffs, rather than from interstate access tariffs used by IXCs." *Id.* ¶ 27. The ESP exemption thus "was and remains an affirmative *exercise* of federal regulatory authority over interstate access service under section 201." *Id.* ¶ 55. The Commission simply adopted, as the "alternative compensation mechanism" available to an ESP for its purchase of interstate access service, *id.* ¶ 28, the intrastate business rate set forth in state tariffs. An ESP that chose this alternative compensation mechanism was excused from paying the otherwise applicable per-minute access rates set forth in federal tariffs.

When two LECs jointly provide an ESP with the interstate access service it uses, they have collaborated not to complete a local call, but instead to provide the initial leg of an interstate call. Accordingly, as with other jointly provided access service, they should "share" the access charges paid — or, put another way (because the incremental per minute access charge amounts to $0), each should look to its own customer (respectively, the end user and the ISP) for compensation. Requiring the incumbent, which had collected no additional access charges in the single-carrier environment, to pay reciprocal compensation to the CLEC simply because the CLEC has inserted itself between the incumbent and the ESP has the effect simply of penalizing the incumbent and subsidizing the CLEC — a result that, as the Commission found, leads to regulatory arbitrage and provides an enormous incentive for CLECs both to serve ESPs and to avoid serving residential customers.

b. The D.C. Circuit also took issue with the Commission's failure to address directly CLECs' claims that ISP-bound traffic is "telephone exchange service" under 47 U.S.C. § 153(47), because the Commission described ISPs as "users of access service," a term not defined in the 1996 Act. *ISP Declaratory Ruling* ¶ 17 (internal quotation marks omitted); *see Bell Atlantic*, 206 F.3d at 8-9. The court presumably was concerned that, if the traffic were properly classified as telephone exchange service (and therefore subject to state jurisdiction), that would create obvious tension with the Commission's finding that ISP-bound traffic is not local for purposes of reciprocal compensation. Because the Commission did not answer this question in the *ISP Remand Order*, the D.C. Circuit explained in *WorldCom* that, once again, it was not deciding "whether handling calls to ISPs constitutes 'telephone exchange service' or 'exchange access' . . . or neither, or whether those terms cover the universe to which such calls might belong." 288 F.3d at 434. As part of a comprehensive, holistic analysis of the Act and its background, the Commission can — and should — confirm that, consistent with decades of precedent, ISP-bound traffic must be classified as "exchange access" under § 153(16), not "telephone exchange service" under § 153(47).

In 1983, it was clear that the service a LEC provided to an ESP was information access, a subset of exchange access.[32] Congress did not disturb this classification in the 1996 Act. The service that LECs offer to ISPs continues to meet the definition of "exchange access," which Congress defined to mean "the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services." 47 U.S.C. § 153(16); *see Advanced Services Remand Order* ¶ 35 (holding that the "service provided by the local exchange carrier to the ISP is ordinarily exchange access service"); *see also, e.g., ISP Remand Order* ¶ 55 & n.107 (ISPs purchase exchange access); *Advanced Services Remand Order* ¶¶ 42-44 (same).[33]

Even if the question were close, the Commission could and should reasonably conclude, in interpreting the ambiguous definitions of exchange access and telephone toll service, that Congress did not intend, *sub silentio*, to define exchange access in the 1996 Act such that information access no longer fit within the category of exchange access, which previously had been defined only in the MFJ. *See id.* ¶ 44; *see also Bell Atlantic*, 206 F.3d at 9 (finding the

[32] *See, e.g., AT&T*, 552 F. Supp. at 196 & n.268 ("the Operating Companies must provide access services to . . . information service providers"; these services "permit the origination or termination of . . . information services"). Information access, in turn, was a subset of exchange access under the MFJ. *See, e.g., id.* at 229 (defining information access as provision of "specialized" exchange access); *Advanced Services Remand Order* ¶ 47 n.99.

[33] The Commission held in the *Advanced Services Remand Order* (¶ 36), and should reaffirm, that "the access service provided by the local exchange carrier is for the 'origination or termination of telephone toll service' within the meaning of the statutory definition." As the Commission has correctly found, ISPs provide "telephone toll service" within the meaning of that term as defined in 47 U.S.C. § 153(48). First, the dial-up service that ISPs offer is a form of "telephone service," a term broad enough to encompass both "telecommunications service" and "information service." Second, ISP-bound traffic, viewed on an end-to-end basis, travels "between stations in different exchange areas." *See, e.g., ISP Remand Order* ¶¶ 52-65. Third, end-user customers of the ISPs pay a "separate charge" that is not included in their contracts with their LEC for exchange service.

1996 Act "ambiguous as to whether calls to ISPs fit within 'exchange access' or 'telephone exchange service,'" so that "any agency interpretation would be subject to judicial deference").

B. Because of the Technical Characteristics of ISP-Bound Traffic, Intercarrier Compensation Would Not Be "Reciprocal" Within the Meaning of § 251(b)(5) and Would Not Permit the "Mutual And Reciprocal Recovery" of Costs Required by § 252(d)(2)

Section 251(b)(5) by its terms provides for "*reciprocal* compensation arrangements." 47 U.S.C. § 251(b)(5) (emphasis added). Section 252(d)(2) provides that a reciprocal compensation arrangement cannot be deemed "just and reasonable" unless it ensures "the *mutual and reciprocal* recovery" of each carrier's costs. *Id*. § 252(d)(2)(A)(i) (emphasis added). If a particular arrangement does not — or intrinsically *cannot* — both operate in a "reciprocal" manner *and* guarantee the "mutual and reciprocal" recovery of costs, it cannot qualify as a "reciprocal compensation arrangement" under § 251(b)(5) and cannot be deemed just and reasonable under § 252(d)(2). Because of the unique technical and regulatory characteristics of ISP-bound traffic, a requirement that carriers enter into an intercarrier compensation arrangement applicable to that class of traffic would be unlawful under both of those provisions. That is so for the following reasons.

First, calls between an ISP and its end-user customers proceed in one direction only — from the end-user to the Internet, via the ISP. Any compensation requirement imposed on such inherently one-way ISP-bound traffic would not be "reciprocal" in any meaningful sense. As the D.C. Circuit previously put it, "since ISPs do not make outgoing calls, this compensation [for ISP-bound traffic] is hardly 'reciprocal.'" *Bell Atlantic*, 206 F.3d at 3.

Second, because such calls "flow[] exclusively in one direction," "so does money in a reciprocal compensation regime" that applies to such traffic — to the LEC serving the ISP. *ISP Remand Order* ¶ 21. This imbalance imposes enormous costs on an incumbent LEC. Because the average holding time of ISP-bound calls is significantly longer than that for normal voice calls, the circuits in the offices serving both the end-user and the ISP are locked up for extended periods, requiring the incumbent to add new switches or expand existing switches to handle the increased burden. And yet the incumbent LEC has no mechanism for recovering the costs imposed by this traffic. The ISP generates no outgoing calls of its own, so the CLEC serving the ISP sends no counterbalancing traffic, and therefore no compensation, to the incumbent. Even at the simplest level, therefore, this exclusively one-way flow of calls and money means that an intercarrier compensation requirement for ISP-bound traffic necessarily fails to provide for the "mutual and reciprocal recovery . . . of costs" required to satisfy the statute's threshold "just and reasonable" test. 47 U.S.C. § 252(d)(2)(A). Recovery of costs cannot be "mutual" and "reciprocal" where compensation flows in only one direction and where the class of traffic for which compensation is paid imposes significant uncompensated costs on the *originating* carrier.

Third, the inequity is actually greater than might appear at first glance because of the unique technical nature of communications between an end user and websites on the Internet. An end-user customer seeking to access the Internet initiates the communication by placing a call to an ISP, which acts as a conduit between the end-user and the Internet (and distant websites on the Internet). Once the initial connection to the Internet is established, however, the telecommunications — that is, the transmission of information — that occurs over that connection overwhelmingly flows *from* the Internet (and the various websites accessed) *to* the end-user. In that sense, the local exchange carrier that originates the call actually ends up *terminating* the lion's share of the telecommunications and therefore the lion's share of the costs of the connection. It is inconceivable that Congress intended to require the "originating" carrier in such circumstances to pay compensation to the carrier serving the ISP, when the information flow moves predominantly in the opposite direction (and actually terminates on the "originating" carrier's network) and when the originating carrier already bears the overwhelming share of the costs and receives no compensation.[34] And any arrangement that required the originating carrier to pay compensation in this context necessarily would not permit the mutual recovery of each carrier's costs, would not be just and reasonable under the terms of § 252(d)(2), and would for that additional reason be contrary to the Act.

II. THE COMMISSION HAD AMPLE AUTHORITY TO ESTABLISH THE COMPENSATION SCHEME ADOPTED IN THE *ISP REMAND ORDER*

Because ISP-bound traffic is inherently interstate in nature, the Commission has the same authority to adopt rules governing compensation for this type of traffic under § 201 that it always has had for other forms of interstate exchange access traffic. And, of course, the Commission's authority to adopt rules governing interstate traffic was expressly preserved in the 1966 Act. *See* 47 U.S.C. § 251(i). Moreover, the Commission would have had authority to adopt those same rules even if, despite the disqualifying statutory conditions discussed above, the Commission were to determine that ISP-bound traffic qualifies for reciprocal compensation under § 251(b)(5). Indeed, the Commission would have had authority to adopt those rules *either* under its general

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[34] ISP-bound traffic is technically different from calls to paging carriers, which the Commission has held can be subject to reciprocal compensation even though paging traffic also flows in only one direction. *See, e.g.*, Memorandum Opinion and Order, *TSR Wireless, LLC v. US West Communications, Inc.*, 15 FCC Rcd 11166, ¶ 21 (2000) ("TSR Wireless"), *aff'd*, *Qwest Corp. v. FCC*, 252 F.3d 462 (D.C. Cir. 2001). In the first place, calls to paging companies are very short — shorter than an average voice call. For this reason, there is no evidence that origination of such traffic has imposed any uncompensated costs on LECs. Moreover, for paging traffic the telecommunications and the compensation flow in the same direction — from the originating carrier to the paging carrier. And, unlike ISP-bound traffic, such calls terminate on the network of the paging carrier, which is not merely a conduit for further communications. Finally, because paging carriers provide a form of CMRS service, the Commission has additional authority over the compensation due to such carriers under § 332. *See Qwest*, 252 F.3d at 465-66 (explaining that the Commission's reciprocal compensation rules, as applied to CMRS providers, are grounded in § 332); *TSR Wireless* ¶ 14 (noting that Eighth Circuit upheld Commission's rules "as a valid exercise of the Commission's authority under section 332(c) of the Act").

authority to adopt rules implementing the reciprocal-compensation provision of the Act, or as transitional rules pending the adoption of a bill-and-keep regime for ISP-bound traffic.

The Commission's authority to adopt rules to implement § 252(d)(2) is beyond question. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-78 (1999). That statutory provision leaves the Commission with significant discretion to establish rules to govern what "additional costs" are to be considered appropriate for compensation. In particular, the Commission has authority to determine, among other things, what costs of delivering traffic are to be recovered through intercarrier compensation rather than from the carrier's customer, whether there should be caps on any such recovery, and whether a mandatory bill-and-keep regime is appropriate under § 252(d)(2)(B). In doing any of these things, the Commission would not be setting a rate under § 252(d)(2). Rather, it would simply be adopting pricing *standards* — a responsibility that Congress entrusted to the FCC. *See AT&T v. Iowa Utils. Bd.*, 525 U.S. at 384.

In the *Local Competition Order*, the Commission stated that, in the context of the exchange of local traffic, "the 'additional cost' to the LEC of terminating a call that originates on a competing carrier's network primarily consists of the traffic-sensitive component of local switching." *Local Competition Order* ¶ 1057. The Commission is free to revisit that determination here with respect to ISP-bound traffic, however, particularly in light of the interstate nature of such traffic. In the case of ordinary local traffic, states establish retail rates and are presumably in an appropriate position to determine, for example, that carriers should be compensated for costs associated with the termination function for traffic originated on a second carrier's network. But in the case of ISP-bound traffic, the rate structure — and, in particular, ISPs' ability to purchase access service from local business tariffs — is purely a function of the federal ESP exemption. The Commission therefore has both plenary authority and special responsibility to interpret the meaning of "additional cost" with respect to this traffic. Because the Commission has determined, with respect to ISP-bound traffic in particular, that carriers should "recover costs from . . . ISP customers" and not "from . . . other carriers and their customers" (*ISP Remand Order* ¶ 76), it follows that the Commission could determine that the "additional cost" of delivering ISP-bound traffic — over and above what can be recovered from the carrier's ISP customer — is zero.

Moreover, the Commission also has authority to adopt a bill-and-keep regime under appropriate circumstances, such as those presented here, and to adopt explicitly interim rules that apply during the transition to such a regime. The Commission itself has suggested that it has authority to adopt a bill-and-keep regime under § 252(d)(2). *See Unified Intercarrier Compensation NPRM* [35] ¶¶ 73-75. The statute provides that, for purposes of compliance with § 251(b)(5), a reciprocal-compensation arrangement must "provide for the mutual and reciprocal recovery by each carrier of the costs associated with the transport and termination" of traffic. 47 U.S.C. § 252(d)(2)(A)(i). It further provides, however, that § 252(d)(2) "shall not be construed . . . to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)." *Id.* § 252(d)(2)(B)(i). This is not to say that bill-and-keep is permissible in all circumstances, such as where the compensation scheme does not in some manner allow carriers to recover their costs. But here, the Commission has determined, as a matter of federal policy, that CLECs' rates are not regulated and that they can and should recover from their own ISP customers the costs associated with serving those ISPs — a determination that falls squarely within the Commission's authority over this interstate traffic. *See ISP Remand Order* ¶ 76. For this reason, bill-and-keep arrangements do "afford . . . mutual recovery of costs" and can be made mandatory (or can be made mandatory after a transitional period of declining rate caps).[36] Although it has not yet had any occasion to resolve the question definitively, the D.C. Circuit has acknowledged that "there is plainly a non-trivial likelihood that the Commission has authority to elect such a [bill-and-keep] system (perhaps under §§ 251(b)(5) and 252(d)[(2)](B)(i))." *WorldCom*, 288 F.3d at 434.

The Commission thus would clearly be within its authority to re-adopt, pursuant to § 252(d)(2), the same rules adopted in the *ISP Remand Order*. The Commission had ample evidence that the existing compensation structure was not merely compensating CLECs for the "additional costs of terminating" ISP-bound traffic, but was leading to a situation where CLECs were granting service discounts and even paying customers for the opportunity to provide service. But if § 252(d)(2) makes anything clear, it is that carriers should not be permitted to offset the costs attributable to the provision of service to *their* customers through intercarrier compensation payments. *See Local Competition Order* ¶ 1058 (noting that "all carriers . . . have a greater incentive and opportunity to charge prices in excess of economically efficient levels on the terminating end"). Application of ordinary reciprocal-compensation rates to ISP-bound traffic was leading to precisely that result. The Commission therefore appropriately set a cap on rates, and allowed individual state commissions to set rates at or below these caps.

As discussed above, the Commission has already laid out in detail the policy reasons supporting a bill-and-keep regime for ISP-bound traffic. *See ISP Remand Order* ¶¶ 2, 5, 7, 67-

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[35] Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610 (2001) ("*Unified Intercarrier Compensation NPRM*").

[36] The Act's legislative history specifically confirms that the term "mutual and reciprocal recovery of costs" was meant to include "a range of compensation schemes, such as *in-kind*

76; *Unified Intercarrier Compensation NPRM* ¶¶ 37-68. Thus, the Commission explained that "the existing intercarrier compensation mechanism for the delivery of [ISP-bound] traffic, in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets." *ISP Remand Order* ¶ 2. Although the problem was "exacerbated by the prevalence of excessively high reciprocal compensation rates," it cannot be solved simply by "attempting to 'get the rate right.'" *Id.* ¶¶ 75-76. When it comes to ISP-bound traffic, "[m]odifications to intercarrier rate levels or rate structures . . . do not address carriers' ability to shift costs from their own customers onto other carriers and their customers." *Id.* ¶ 76. A bill-and-keep system, by contrast, can "eliminate these [market-distorting] incentives and concomitant opportunity for regulatory arbitrage by forcing carriers to look only to their ISP customers, rather than to other carriers, for cost recovery." *Id.* ¶ 74.

Moreover, the Commission has a special *obligation* to adopt rules to ensure that the intercarrier compensation regime, as applied to ISP-bound traffic, does not produce uneconomic results. As the Commission has recognized, ISPs use the local network in a manner analogous to long-distance carriers — that is, they gain access to the local network in order to make interexchange communication services available to their particular subscribers. The proper way for the costs of that access to be recovered is from the cost causers — *i.e.*, the ISPs and their subscribers — not from all local exchange subscribers equally. But, as a result of the ESP exemption, ISPs can purchase access to the local exchange as if they were local business end users, not interstate communications providers. For that reason, any additional costs imposed on the network as a result of the special characteristics of ISP-bound traffic cannot be recovered

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exchange of traffic without cash payment (known as bill-and-keep arrangements)." S. Rep. No.

from ISPs and their customers. The ESP exemption is a federal policy, and reciprocal compensation is a federal mandate. The FCC thus has plenary authority — and a responsibility — to determine what cost-recovery mechanism is appropriate for this particular category of traffic, even if it were covered by § 251(b)(5). As the Commission has correctly determined, because of the unique attributes of ISP-bound traffic, provision of intercarrier compensation for this type of traffic over and above compensation received from end users produces regulatory distortions and harms competition. The Commission therefore can and must adopt rules that help to ameliorate that result.

For these reasons, and as set forth much more fully in both the *ISP Remand Order* and the *Unified Intercarrier Compensation NPRM*, the Commission had ample authority to adopt appropriate rate caps for ISP-bound traffic, to leave such caps in place pending a comprehensive resolution of intercarrier compensation issues, or to move to bill-and-keep for ISP-bound traffic. The Commission should exercise that authority to promote the Act's pro-competitive goals.

III. THE ARGUMENTS OF COMPANIES SEEKING TO BENEFIT FROM "REGULATORY ARBITRAGE" OPPORTUNITIES AND "WINDFALL" PAYMENTS MUST BE REJECTED

A. An Order Treating ISP-Bound Traffic as Equivalent to Local Voice Traffic for Purposes of Reciprocal Compensation Could Not Be Sustained

As the foregoing arguments demonstrate, interpreting the Act to subject ISP-bound traffic to reciprocal compensation would not reflect a cohesive reading of the various provisions of the Act that are relevant and would not be sustainable for that reason alone. Just as important, subjecting ISP-bound traffic to the obligation to pay reciprocal compensation at state-set rates could not pass muster for an additional reason. The Commission previously has concluded that this would be flatly contrary to the core objectives of the 1996 Act and would produce bizarre

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104-230, at 125 (emphasis added).

and fundamentally irrational results. Any such reading of the Act could not be sustained for this reason as well.

The Commission already has held, based on its review of "convincing evidence in the record," that treating ISP-bound traffic as local voice traffic for purposes of reciprocal compensation "created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets." *ISP Remand Order* ¶ 2. CLECs' decision to serve ISPs was being "driven by regulatory opportunities that disconnect costs from end-user market decisions" — specifically, the nearly "two billion dollars" in annual payments that state commissions had made available in reciprocal compensation for ISP-bound traffic. *Id.* ¶ 5. The Commission explained that the record was "replete with evidence that reciprocal compensation provides enormous incentive for CLECs to target ISP customers." *Id.* ¶ 70. Indeed, the lure of these reciprocal compensation payments "provided an inducement to fraudulent schemes to generate dial-up minutes," in addition to enabling CLECs to offer free service to ISPs and to pay ISPs to be their customers — all of which "convinced" the Commission "that intercarrier payments for ISP-bound traffic have created *severe market distortions*." *Id.* ¶¶ 70 & n.134, 76 (emphasis added).

The Commission found, moreover, that the "classic regulatory arbitrage" that resulted from payment of reciprocal compensation for ISP-bound traffic "had two troubling effects." *Id.* ¶ 21. The first, as described above, was that the "large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services." *Id.* But the second was even more pernicious, in light of Congress's objectives in enacting the 1996 Act and opening local telephone markets to competition. The availability of these "large . . . flows of cash" had "created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act." *Id.* Under a regime where ISP-bound traffic is subject to reciprocal compensation, residential customers served over CLEC facilities were *liabilities* to CLECs — not potential business opportunities as Congress intended — because those customers' ISP-bound calls would expose the CLEC to massive revenue outflows. These "distortion[s]," the Commission found, "prevent[] market forces from distributing limited investment resources to their most efficient uses" — such as the deployment of broadband facilities and the innovative services that could be provided over those new facilities. *Id.* ¶ 4.

Based on "all of the evidence in this record" compiled at that point, the Commission concluded that there was "a need for *immediate action* with respect to ISP-bound traffic." *Id.* ¶ 7 (emphasis added); *see also id.* ¶ 76 (recognizing need "to remedy an *exigent* market problem") (emphasis added). Nothing has occurred in the intervening years to call any of the Commission's determinations into question. Many CLECs still do little more than serve ISPs to the exclusion of other types of customers, especially residential customers. The vast majority of the traffic that Verizon delivers to all CLECs *still* is bound for ISPs, and the volume of traffic that is involved has not declined since the Commission last visited this issue. In the first quarter of 2004, CLECs in the former Bell Atlantic states received, on average, nearly *15 times* as much traffic as they originated, with some CLECs receiving more than *145 times* as much traffic as they originated. And CLECs have continued to use every legal stratagem — including delaying amendments to existing agreements and the signing of new agreements to forestall the application of the Commission's rate regime, and claiming that reciprocal (or intercarrier) compensation is due on *all* calls to ISPs, even if the ISP is located in another state — so that they can "shift [the] costs [of serving ISPs] from their own customers onto other carriers and their customers." *Id.* ¶ 76; *see id.* ¶ 4 ("given the opportunity, carriers *always* will prefer to recover their costs from other carriers rather than their own end-users in order to gain competitive advantage").

In light of its own unrebutted and irrefutable findings, the Commission could not plausibly claim that Congress mandated — or that the Act is reasonably interpreted to require — payment for ISP-bound traffic as though it were no different from local voice traffic. Indeed, it is axiomatic that the Commission cannot read § 251(b)(5) in manner that undermines Congress's goals in enacting the 1996 Act — and that is contrary to the Commission's own policy determinations. *See International Alliance of Theatrical & Stage Employees v. NLRB*, 334 F.3d 27, 35 (D.C. Cir. 2003) (finding "unreasonable under *Chevron* step two" an agency interpretation that "upset[] the statutory balance struck by Congress and [led] to irrational results in practice"); *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 689 (1973) ("our duty is to favor an interpretation which would render the statutory design effective in terms of the policies behind its enactment and to avoid an interpretation which would make such policies more difficult of fulfillment"); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) ("an agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored"). Accordingly, any decision reversing the Commission's earlier determinations that ISP-bound traffic is not subject to reciprocal compensation would be unsustainable.

B. Treating ISP-Bound Traffic as Equivalent to Local Voice Traffic Would Conflict with Other Commission Objectives and Initiatives

In a number of proceedings, the Commission is seeking to assert exclusive federal authority over the Internet and Internet-Protocol-based traffic and services. *See, e.g.*, Notice of Proposed Rulemaking, *IP-Enabled Services*, WC Docket No. 04-36, FCC 04-28 (rel. Mar. 10, 2004); Memorandum Opinion and Order, *Petition for Declaratory Ruling That pulver.com's Free World Dialup Is Neither Telecommunications Nor a Telecommunications Service*, WC Docket No. 03-45, FCC 04-27 (rel. Feb. 19, 2004); Petition for Declaratory Ruling, *In the Matter of Vonage Holdings Corporation; Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, WC Docket No. 03-211 (FCC filed Sept. 22, 2003); Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers*, 17 FCC Rcd 3019 (2002); Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities*, 17 FCC Rcd 4798 (2002), *vacated in part on other grounds*, *Brand X Internet Servs. v. FCC*, 345 F.3d 1120 (9th Cir. 2003). A ruling that ISP-bound traffic is subject to reciprocal compensation — *and therefore subject to state jurisdiction* — would directly undermine those efforts, by assigning a key component of the Commission's overall policy to the states. Dividing responsibility over Internet traffic in this manner prevents the establishment of a single, coherent, national policy on these issues, while inviting inconsistent determinations.

In addition, the Commission is currently considering a broader reform of the rules governing intercarrier compensation regime for *all* traffic, interstate and intrastate, exchanged between all carriers. *See* Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610 (2001). It would be surpassing strange for the Commission simultaneously to put state commissions in charge of regulating intercarrier compensation for one type of *interstate* traffic. This is all the more true when ISP-bound traffic constitutes a significant, and bitterly contested, facet of the compensation issue. Instead of a single regime, the Commission would create 51 separate regimes for ISP-bound traffic, alongside a single federal regime for all other interstate traffic, if not all other traffic.

In contrast, reaffirming the result reached in the *ISP Declaratory Ruling* and the *ISP Remand Order* — and accompanying that result with the holistic analysis sought by the D.C. Circuit — is consistent with the Commission's other regulatory initiatives and objectives. And, of course, retaining federal jurisdiction over intercarrier compensation for ISP-bound traffic is consistent with the more than 20 years of precedent in which the Commission has regulated the service that LECs provide to ISPs on the ground that it is an "*interstate* access service." *ISP Remand Order* ¶ 55 (emphasis added); *see id.* ¶ 55 & n.107 (citing precedent).

C. Any Further Order Addressing ISP-Bound Traffic Must Be Given Prospective Effect Only and Must Address the Scope of Any Compensation Rules Adopted

1. Even if the Commission were to now alter its existing rules governing ISP-bound traffic or to adopt entirely new rules — whether by moving to bill-and-keep or otherwise modifying the current rules, or whether by (incorrectly) subjecting this traffic to § 251(b)(5) — the Commission should adhere to its past practice of making such a determination prospective only and refraining from interfering with existing agreements. In the *ISP Remand Order*, for example, the Commission was careful to state that its interim intercarrier compensation regime would apply prospectively only, "as carriers re-negotiate expired or expiring interconnection agreements" or incorporate those rules into existing agreements through "contractual change-of-law provisions." *ISP Remand Order* ¶ 82; *see id.* ("Order does not preempt any state commission decision regarding compensation for ISP-bound traffic for the period prior to the effective date of the interim regime"). And, in that order, as well as in the *ISP Declaratory Ruling*, the Commission refused to prejudge pending disputes about the interpretation of existing agreements or to upset state commission decisions interpreting those agreements *not* to require compensation for ISP-bound traffic at the same rate as voice traffic. *See id.* ¶ 80 (Order has "no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps we adopt here or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic)"); *ISP Declaratory Ruling* ¶ 24 ("state commissions, not this Commission, are the arbiters of what factors are relevant in ascertaining the parties' intentions").

Carriers entering into interconnection agreements have consistently relied on the Commission's interpretation of § 251(b)(5) in effect at that time — whether the Commission's initial determination that § 251(b)(5) applies to local traffic only or its later determinations that § 251(b)(5) does not apply to ISP-bound traffic. *See AT&T Communications of Southern States, Inc. v. BellSouth Telecomms., Inc.*, 229 F.3d 457, 465 (4th Cir. 2000) ("many so-called 'negotiated' provisions represent nothing more than an attempt to comply with the requirements of the 1996 Act"); *BellSouth Telecomms., Inc. v. MCImetro Access Transmission Servs., Inc.*, 317 F.3d 1270, 1281 (11th Cir. 2003) (en banc) (Anderson, J., concurring) ("as a practical matter, even a voluntarily negotiated agreement . . . is cabined by the obvious recognition that the parties to the agreement had to agree within the parameters fixed by the federal standards"). In addition, LECs generally relied on the Commission's rules in negotiating their agreements and in setting the compensation (if any) that would apply to this traffic. ILECs in particular relied specifically on the rules promulgated in the *ISP Remand Order* when, to take advantage of the interim compensation regime for ISP-bound traffic, they were compelled to agree to receive materially lower payments from *all* CLECs on traffic that had always been subject to § 251(b)(5). *See ISP Remand Order* ¶ 89 & n.179. It would be inequitable — and impermissibly retroactive — to deprive ILECs of the benefit of this bargain by applying a new rule requiring higher payments for ISP-bound traffic only; and it would be impossible to undo the effects of that bargain. *See Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1207 (D.C. Cir. 1996); *see also Celtronix Telemetry, Inc. v. FCC*, 272 F.3d 585, 588-89 (D.C. Cir. 2001). Any attempt to undo that bargain would obligate the Commission to compel CLECs and CMRS providers that obtained the benefit of lower payments for traffic delivered to ILECs to make the ILECs whole, setting off new rounds of litigation and often involving carriers that are insolvent or no longer in business.

More generally, because the Commission has consistently ruled that § 251(b)(5) does not require payment of reciprocal compensation for ISP-bound traffic, any decision now to adopt a new rule requiring the payment of intercarrier compensation for such traffic would be a sharp departure from the Commission's consistent view of the statute. *See Declaratory Ruling* ¶ 26 n.87; *Advanced Services Remand Order* ¶ 35 n.77; *ISP Remand Order* ¶¶ 1, 23; *Starpower Order*[37] ¶ 31 ("the Commission consistently has concluded that ISP-bound traffic does not fall within the scope of traffic compensable under section 251(b)(5)"). Although the D.C. Circuit has remanded the Commission's prior rulings addressing ISP-bound traffic, the court left in place pending remand the Commission's most recent determination that the Act does not require reciprocal compensation for ISP-bound traffic. *See WorldCom*, 288 F.3d at 434. As explained above, the effect of the D.C. Circuit's decision, as the Commission itself has recognized, is that the rules promulgated in the *ISP Remand Order* have been in effect since June 14, 2001, and remain in effect today.

If the Commission decides to make ISP-bound traffic compensable under § 252(d)(2), it therefore must do so on an exclusively forward-looking basis, because the compensation requirement would constitute an entirely new rule that would displace the Commission's previous rules on the subject. The D.C. Circuit has stated the "governing principle" as follows: "[W]hen there is a 'substitution of new law for old law that was reasonably clear,' the new rule may justifiably be given prospectively-only effect in order to 'protect the settled expectations of those who had relied on the preexisting rule.' By contrast, retroactive effect is appropriate for 'new applications of [existing] law, clarifications, and additions.'" *Public Serv. Co. v. FERC,* 91 F.3d 1478, 1488 (D.C. Cir. 1996) (quoting *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993) (alteration in original)).

When an agency changes course in this manner, retroactivity must be denied "in order to protect the settled expectations of those who had relied on the preexisting rule." *Williams Natural Gas*, 3 F.3d at 1554. There is simply no question that the Commission has held repeatedly and specifically, over the course of five years, that ISP-bound traffic is *non*-compensable for purposes of §§ 251(b)(5) and 252(d)(2). Existing law is therefore clear. A new interpretation under which LECs are required for the first time to pay intercarrier compensation for such traffic cannot be characterized as merely a new application or clarification of existing law or an incremental addition to current rules. Rather, it would be a 180-degree reversal of the Commission's preexisting view of the statute. This is a paradigmatic case for purely prospective application of the new rule.[38]

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[37] *Starpower Communications, LLC v. Verizon Virginia, Inc.*, 17 FCC Rcd 6873 (2002) ("*Starpower Order*"), *remanded*, 334 F.3d 1150 (D.C. Cir. 2003).

[38] We recognize that the Commission's prior rulings on this issue have been remanded and that "agencies have greater discretion to impose their rulings retroactively when they do so in response to judicial review." *Verizon Tel. Cos. v. FCC*, 269 F.3d 1098, 1111 (D.C. Cir. 2001). But the D.C. Circuit expressly declined to vacate the Commission's most recent ruling on this issue, *see WorldCom*, 288 F.3d at 434, and the Commission's prior ruling accordingly "remain[ed] in effect," *BellSouth 271 Order* ¶ 272. LECs therefore could and did properly rely on those rulings in entering into interconnection agreements.

2. In addition, to the extent any further order preserves any payment obligation for ISP-bound traffic — whether at the currently effective rates or at different rates, and whether such an obligation is imposed under § 251(b)(5) or another provision — the Commission must address explicitly the scope of any such compensation obligation. The failure to address this issue, and to resolve it clearly, would only result in yet more litigation about the compensation, if any, due for traffic delivered to ISPs. Indeed, because of the Commission's silence, in the *ISP Remand Order*, on whether its interim compensation regime was limited to calls to an ISP in the same local calling area as the calling party — that is, to calls that would have been subject to reciprocal compensation if made to a voice customer — CLECs have argued that the interim regime applies to *all* calls to ISPs, including long-distance and 1-800 calls. Although there is no basis to these arguments — the question before the Commission has always been whether calls to an ISP in the same local calling area as the calling party are to be treated the same as calls to a local business[39] — the Commission should avoid any future uncertainty by specifying clearly that interexchange calls to ISPs are not subject to any compensation regime it adopts.

Indeed, any decision requiring payment of reciprocal compensation for ISP-bound traffic must be made with recognition of the fact that end users often call ISPs that are physically located in another exchange — that is, these end users make a call that is indisputably interexchange even before it gets to the ISP's premises. End users do so by making a toll or long-distance call (rarely), using a 1-800 number (somewhat more common), or (most often)

[39] Thus, in the *ISP Declaratory Ruling*, the Commission rejected CLECs' arguments that a call to an ISP "terminate[s] at the ISP's *local* server" and "ends at the ISP's *local* premises." *ISP Declaratory Ruling* ¶¶ 12-15 (emphases added). Indeed, only the ISP is located in the same local calling area as the calling party could a call to an ISP ever "originate[] and terminate[] *within a local service area*." 47 C.F.R. § 51.701(b)(1) (1996). And the ESP exemption simply enables *ESPs* to avoid paying access charges; it does not relieve a CLEC or an IXC from paying

through a "virtual" foreign exchange service that the ISP purchases from a CLEC. No matter how the Commission interprets § 251(b)(5), interexchange calls to ISPs should be treated the same as interexchange calls to non-ISP customers, and neither should qualify for reciprocal compensation

This should be self-evident in the case of toll, long-distance, and 1-800 calls to an ISP. In each case, a CLEC "obtains the same circuit-switched inter[exchange] access . . . as obtained by other interexchange carriers" and imposes at least "the same burdens on the local exchange as do circuit-switched interexchange calls" to voice customers. Order, *Petition for Declaratory Ruling That AT&T's Phone-to-Phone IP Telephony Services Are Exempt from Access Charges*, WC Docket No. 02-361, FCC 04-97, ¶ 15 (rel. Apr. 21, 2004). Access charges indisputably apply to toll, long-distance, and 1-800 calls to voice customers. There is no reason to apply a different compensation rule when such calls are made to ISPs. On the contrary, such a rule would simply create a new arbitrage opportunity for CLECs by relieving them, for example, from paying the access charges they currently pay for 1-800 calls to their ISP customers.

For this reason, reciprocal compensation also should not apply to interexchange calls that appear "local" because of the number the CLEC has assigned to its ISP customer. Many CLECs provide their ISP customers with an interLATA FX service, picking up traffic in one LATA and delivering that traffic to ISPs in another LATA (or another state). Global NAPs, for example, has assigned telephone numbers associated with calling areas throughout *New England* to ISPs located at or near its switch in Quincy, Massachusetts. After receiving these calls from Verizon at its point of interconnection in Vermont or New Hampshire, GNAPs transports the calls across LATA and state boundaries before handing them off to its ISP customers. Level 3 has similarly

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applicable charges when an ESP receives an intrastate or interstate *inter*exchange (or assigned numbers associated with calling areas in the Pittsburgh LATA to ISPs located in Baltimore. *See, e.g.*, Opinion and Order, *Level 3 Communications, LLC v. Marianna & Scenery Hill Tel. Co.*, C-20028114 (Pa. PUC Jan. 7, 2003). Level 3 receives these calls in Pittsburgh and then transports them across LATA and state boundaries to the ISP in Maryland. These calls are no different from an interLATA FX service enabling an airline office in Atlanta to receive calls from customers in Washington, D.C., without those customers incurring toll calls. The Commission's prior determination, described above, that such interLATA FX calls are subject to access charges should be dispositive here as well. *See Bell Atlantic-Pennsylvania* ¶¶ 71, 80.

Another common arrangement that CLECs use to provide service to their ISP customers is known as Virtual FX or Virtual NXX. For example, a CLEC with a switch in Philadelphia would assign its ISP customers — normally collocated at its switch or located only a short distance away — telephone numbers associated with calling areas throughout the Philadelphia LATA including, for example, the Allentown local calling area. Normally, a call from a customer in Allentown to a customer in Philadelphia would be a toll call, and the incumbent, as the originating carrier, could either collect toll charges from its customer or access charges from the IXC. But, because the CLEC has assigned its customer a "local" Allentown number, the incumbent's systems would be tricked into thinking that the call was delivered in Allentown. The incumbent would not receive the compensation normally due on an interexchange call, even though the incumbent would perform the interexchange transport necessary to deliver the call from Allentown to the CLEC's chosen point of interconnection near its switch in Philadelphia. Moreover, the CLEC would seek reciprocal compensation for such a call — on top of the compensation it already receives from its customer. Because the incumbent alone bears the

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*inter*LATA) call.

interexchange transport costs,[40] the Virtual FX arrangement sends inappropriate price signals and leads to extensive use of this arrangement. Indeed, for some CLECs, 100% of the traffic they deliver to ISPs is Virtual FX traffic.[41]

The overwhelming majority of state commissions to consider this issue have held that Virtual FX calls are interexchange calls that are not subject to reciprocal compensation, or have refused to permit CLECs to provide Virtual FX arrangements altogether.[42] These commissions

[40] The ILEC's customer does not bear those costs because of the CLEC's number assignment practice. Neither the CLEC nor its customer bears those costs because the ILEC performs the transport.

[41] *See* Memorandum Opinion and Order, *Starpower Communications, LLC v. Verizon South Inc.*, 18 FCC Rcd 23625, ¶ 17 n.64 (2003) ("*Starpower Damages Order*"). Calls to an ISP that subscribes to an ILEC traditional FX service also should not be subject to reciprocal compensation — they too are interexchange calls before they reach the ISP. But the fundamental difference between traditional FX and Virtual FX is that the ILEC and its customer bear the costs of the interexchange transport, because the ILEC deploys a private line connecting its customer to a distant switch, for which the customer pays. Because FX customers thus bear the costs of this service, the incidence of FX traffic is minimal — well under one-half of one percent.

[42] State commissions in Connecticut, Florida, Georgia, Illinois, Massachusetts, Missouri, New Hampshire, New Jersey, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, and Texas have all held that reciprocal compensation is not required for VNXX traffic. *See* Decision, Docket No. 01-01-29 (Conn. DPUC Jan. 30, 2002), *aff'd*, Docket No. 01-01-29 (Conn. DPUC Nov. 13, 2002); Final Order on Petition for Arbitration, Docket No. 020412-TP, Order No. PSC-03-0762-FOF-TP (Fla. PSC June 25, 2003); Final Order, Docket No. 13542-U (Ga. PSC rel. July 23, 2001); Arbitration Decision, Docket No. 01-0338 (Ill. CC Aug. 8, 2001); Order, D.T.E. 02-45 (Mass. DTE Dec. 12, 2002) ("*Massachusetts Order*"); Arbitration Order, Case No. TO-2001-455 (Mo. PSC rel. June 7, 2001); Order, Docket No. TO02060320 (N.J. BPU Jan. 26, 2004), *aff'g* Recommended Decision, Docket No. TO02060320 (N.J. BPU Mar. 7, 2003); Final Order, DT 02-107, Order No. 24,087 (N.H. PUC Nov. 22, 2002); Arbitration Award, Case No. 02-876-TP-ARB (Ohio PUC Sept. 5, 2002); Opinion and Order, Docket No. A-310771F7000 (Pa. PUC Apr. 17, 2003); Final Arbitration Decision and Order, Docket No. 3437 (R.I. PUC rel. Jan. 24, 2003); Order on Arbitration, Docket No. 2002-181-C, Order No. 2002-619 (S.C. PSC Aug. 30, 2002) ("*South Carolina Order*"); Final Order of Arbitration Award, Docket No. 99-00948 (Tenn. RA Sept. 7, 2001), *aff'g* Interim Order of Arbitration Award, Docket No. 99-00948 (Tenn. RA June 25, 2001); Revised Arbitration Award, Docket No. 21982 (Tex. PUC Aug. 31, 2000). State commissions in Iowa, Maine, and Vermont have refused to permit CLECs to provide Virtual FX service. *See* Final Decision and Order, Docket Nos. SPU-02-11 & SPU-02-13 (Iowa DCUB rel. June 6, 2003); Order Requiring Reclamation of NXX Codes and Special ISP Rates by ILECs; Order Disapproving Proposed Service, Docket Nos. 98-758 & 99-593 (Me. PUC rel. June 30, 2000); Order, Docket No. 6742 (Vt. PSB Dec. 26, 2002)

have also recognized that attempts to force ILECs to pay reciprocal compensation for Virtual FX traffic is "an extraordinarily clear example of attempted regulatory arbitrage" and "deeply inconsistent with regulatory policy and basic fairness." *South Carolina Order* at 27. The Massachusetts commission similarly concluded that requiring payment of reciprocal compensation for Virtual FX traffic "would artificially shield [the CLEC] from the true cost of offering the service," resulting in "a considerable market distortion based on an implicit Verizon subsidy of [the CLEC's] operations." *Massachusetts Order* at 36-37. And, as the Vermont commission determined, Virtual FX "does not in any way represent an innovation of the sort that competition is intended to encourage," but instead is "an artificial service," "equivalent [to] an incoming 1-800 service, without [the CLEC] having to pay any of the costs associated with deploying that service." *Vermont Order* at 21.

The proper solution — as these state commissions have found — is that the CLEC must either reconfigure its service in a way that permits the ILEC to charge its customers for the toll calls they are making or to compensate the ILEC for the interexchange service that the CLEC and its customer receives. *See TSR Wireless* ¶ 31 ("the same call [may] be[] viewed as a local call by the carriers and a toll call by the end-user," "nothing prevents U S West from charging its end users for [such] toll calls"), *aff'd*, *Qwest Corp. v. FCC*, 252 F.3d 462 (D.C. Cir. 2001). This is precisely what the Texas Public Utility Commission held in a recent decision, where a CLEC was assigning numbers associated with San Marcos to ISP customers actually located in Austin. The Texas commission held that the ILEC "may charge intraLATA toll" rates for calls to the CLEC's Austin-based ISPs, even though the San Marcos numbers appeared "local" to the calling

("*Vermont Order*"), *aff'd*, *Global NAPs, Inc. v. Verizon New England Inc.*, No. 03-CV-97 (D. Vt. Jan. 9, 2004) (unpublished). As against these 17 commissions, no more than five state commissions have reached the opposite result.

party. Order, *Complaint, Request for Expedited Ruling, Request for Interim Ruling, and Request for Emergency Action of ASAP Paging, Inc. Against CenturyTel of San Marcos, Inc.*, Docket No. 25673, at 7 (Tex. PUC Oct. 9, 2003) ("the geographic location of the calling customer and the called customer is the appropriate factor for differentiating toll calls from [local] calls").

The Commission's decision in the *Starpower Damages Order* and the Wireline Competition Bureau's decision in the *Virginia Arbitration Order*[43] are not to the contrary. As the Commission has made clear, neither case addressed the question whether Virtual FX calls to ISPs are subject to reciprocal compensation under § 251(b)(5). *See Starpower Damages Order* ¶ 17 n.63 ("Wireline Competition Bureau did not address the legal question of whether incumbent local exchange carriers have an affirmative obligation under the Act to provide reciprocal compensation for virtual NXX traffic"); *id.* ¶ 17 n.68 ("In this complaint proceeding, we need not and do not address the legal and policy question of whether incumbent LECs have an affirmative obligation under sections 251(b)(5) and 252(d)(2) of the Act (47 U.S.C. §§ 251(b)(5), 252(d)(2)) to pay reciprocal compensation for virtual NXX traffic."). The one time the Commission did address that question, it rejected a CLEC's claim that § 251(b)(5) requires payment of reciprocal compensation for Virtual FX calls, holding that there is "no clear [FCC] precedent or rules declaring [that ILECs have the] duty" to "pay reciprocal compensation for virtual [FX] traffic." *Verizon Three-State 271 Order*[44] ¶ 151.

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[43] Memorandum Opinion and Order, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, 17 FCC Rcd 27039 (2002) ("*Virginia Arbitration Order*").

[44] Memorandum Opinion and Order, *Application by Verizon Maryland Inc., et al., for Authorization To Provide In-Region, InterLATA Services in Maryland, Washington, D.C., and West Virginia*, 18 FCC Rcd 5212 (2003) ("*Verizon Three-State 271 Order*").

Instead, the *Virginia Arbitration Order* and the *Starpower Damages Order* rested on the ground that excluding Virtual FX calls from reciprocal compensation raises intractable practical issues. *See Starpower Damages Order* ¶ 17 (carriers "apparently lack[] the technical capability to identify virtual NXX calls");[45] *Virginia Arbitration Order* ¶ 301 (identifying Virtual FX calls "raises . . . technical issues that have no concrete, workable solutions at this time"). But those decisions are incorrect insofar as they suggest that carriers cannot — or could not in 1996 — exclude Virtual FX calls from their reciprocal compensation bills. The industry has long developed factors and estimates to apply when it is unable to identify with precision the amount of a particular type of traffic exchanged. *See Access Charge Subelements Order* ¶ 66 (noting that the industry had been required to, and did, develop methods to estimate the volume of Feature Group A traffic, which like Virtual FX traffic appears "local"). Moreover, since the *Virginia Arbitration Order*, Verizon has proposed — and state commissions have adopted as workable — a method for identifying the amount of traditional and Virtual FX traffic, through the simple expedient of having each carrier keep track of the FX numbers it assigns to its own customers. *See, e.g., South Carolina Order* at 28-29 (finding that Verizon had proposed a workable solution for distinguishing from non-Virtual FX traffic). Any practical problems in implementing a rule excluding Virtual FX calls to ISPs could not justify extending the reciprocal compensation requirement to a class of indisputably interexchange calls, particularly given CLECs' past exploitation of this loophole in the billing systems to engage in further regulatory arbitrage involving ISP-bound traffic.

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[45] The Commission also noted that, at the time the parties entered into the agreement at issue in the *Starpower Damages Order*, "no court or state commission . . . or Commission decision had . . . held that virtual NXX traffic was not subject to reciprocal compensation." *Starpower Damages Order* ¶ 17. As explained above, that is not the case today.

Respectfully submitted,

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